THE STATE OF THE INTERNATIONAL FINANCIAL SYSTEM AND THE INTERNATIONAL MONETARY FUND

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THE STATE OF THE INTERNATIONAL FINANCIAL SYSTEM AND THE INTERNATIONAL MONETARY FUND

THURSDAY, FEBRUARY 28, 2002

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, DC.

The committee met, pursuant to call, at 1:05 p.m., in room 2128, Rayburn House Office Building, Hon. Michael G. Oxley, [chairman of the committee], presiding.

Present: Chairman Oxley; Representatives Leach, Bereuter, Lucas, Paul, Gillmor, Weldon, Ose, Biggert, Tiberi, LaFalce, Frank, Waters, Sanders, Sherman, Inslee, Gonzalez and Lucas.

Chairman OXLEY. The hearing will come to order. Good afternoon. This hearing of the Committee on Financial Services will please come to order. Pursuant to the Chair's prior announcement, I'll recognize myself for 5 minutes for an opening statement, as well as the Ranking Minority Member, the Chair and Ranking Minority Member of the Subcommittee on International Monetary Policy and Trade for 3 minutes each.

All Members' opening statements will be made part of the record and it is so ordered.

Today, the Committee is meeting to hear testimony from the Secretary of the Treasury, Mr. Paul H. O'Neill, on the state of the international financial system, IMF Reform, and compliance with IMF agreements. This hearing is mandated by the fiscal year 1999 foreign operations appropriations bill, which provided for an $18 billion increase in U.S. funding for the International Monetary Fund—IMF. To ensure that the IMF would effectively use these funds, Congress included as a requirement, authored by Representative Castle, a senior Member of our Committee, that the Treasury Department submit an annual report on the progress of IMF reforms and that the Treasury Secretary testify before this Committee on the state of the international financial system.

As I am sure you are aware, Mr. Secretary, this Committee heard from Federal Reserve Board Chairman Alan Greenspan just yesterday about the conduct of monetary policy and the state of the domestic economy. Inasmuch as economic growth in the United States is necessarily intertwined with that of the remainder of the world, our Nation's economic growth is greatly impacted by disturbances and/or crises in the international economy, such as that currently occurring in Argentina. As a result, this Committee welcomes this opportunity to both oversee U.S. international economic policy and at the same time looks very much forward to your insights into where that economic policy is heading.

At your appearance last year, you testified that reform of the international financial institutions was a key priority for this Administration and emphasized the need for the IMF and the World Bank to focus more narrowly on their core objectives.

You highlighted a number of issues, among them transparency, accountability, IMF crisis prevention, converting loans to grants, increased education in poor countries, and the use of results-based performance indicators. The Department's October 2001 report provides a helpful review to your testimony, as well as an early insight into the success the Administration has had in pursuing congressional directives codified in Section 1503 of the International Financial Institutions Act related to market-oriented reforms, trade liberalization, sound banking systems, work-out systems for sovereign debt and a host of other issues.

With a year as Secretary under your belt, the Committee looks particularly forward to your assessment of progress on these fronts.

In light of the almost daily news on Argentina's financial turmoil, and the IMF's more than 20-year relationship with Argentina, I would expect that you will receive quite a number of questions about this long-term relationship and how Argentina could possibly find itself in the financial plight that it currently faces.

Turkey is also a subject of interest, although perhaps less so than Argentina, since it has not faced suspension of IMF assistance. There is also a very strong interest in the Japanese economy. Although the Japanese are not recipients of IMF assistance, the IMF is conducting a Financial Sector Assessment Program in Japan. We would certainly welcome your thoughts on the prospects that Japan will finally address the long-term problem of non-performing loans in its banking system.

While I am personally not of the opinion that the IMF and World Bank have done their jobs in ways that call for radical changes in the manner in which they undertake their responsibilities, I do nevertheless feel that the Treasury Department's annual review, as it relates to IMF reform, is and will be of particular importance on a going-forward basis, and I look very much forward to receiving your views on this and other matters of import that you would like to discuss this afternoon.

Let me just take a moment in closing to say how much I personally appreciate the strong leadership skills that you have frequently exhibited during your service at Treasury to date. Please also know that this Committee appreciates the good work that you and other members of your team have accomplished, such as reform of the Multilateral Development Banks and the International Monetary Fund; combating the financing of terrorism, and working very closely with us on our money laundering legislation; the reconstruction of Afghanistan; attempts to raise the level of sustained global economic growth; and lastly, ongoing efforts to strengthen the bilateral economic relationship between the United States and Russia.

With all that being said, Mr. Secretary, let me welcome you to your third appearance before our Committee. It's good to have you.

And I now yield to the gentleman from New York, the Ranking Member, Mr. LaFalce.

[The prepared statement of Hon. Michael G. Oxley can be found on page 34 in the appendix.]

Mr. LAFALCE. Thank you very much, Mr. Chairman.

Secretary O'Neill, welcome. You appear before us at a very important time for the global economy and for United States policies as they relate to the global economy. Today, I would like to highlight two areas. First, the on-going negotiations to replenish the World Bank's International Development Association, so-called IDA, and the discussions related to the creation of a mechanism for handling debt crises, particularly in the aftermath of the Argentine debt default.

First, I'd like to offer my support for your efforts to shift more of IDA assistance toward grants. The grants initiative is a natural extension of our debt relief efforts which are already bearing some fruit in the heavily indebted poor countries, never enough, but they are freeing up some budgetary resources in those countries to devote to critical social spending. Yet, each year that we continue to provide 99 percent of IDA assistance in the form of loans, particularly for non-economic expenditures, such as AIDS relief, nutrition and education, we chip away at the benefits that debt relief provides to these countries. So, in effect, we forgive debt with one hand and pile on new debt with the other.

You don't think and I don't think that this is a viable long-term development strategy. Few of the objections that critics to the grants proposal have ring true to me. In particular, that a shift to grants inappropriately moves the World Bank onto the United Nations turf as the international grant making institution. I think those arguments smack of defending the status quo at the expense of doing what's best for the world's poor. So that's where I agree with you.

Now, I do think though that the intransigence of the Europeans on this issue may reflect some other problems with the United States' position when it comes to funding for IDA and for official development assistance in general. Some individuals who I greatly respect, for example, David Beckman of Bread For the World, has said that these critics are suspicious of the grants proposal because they've long perceived the United States to be stingy when it comes to development assistance. And I think that perception is correct.

You've attempted to counter that perception by offering increases in the IDA contribution over the next 3 years, starting at $850 million in 2003 and increasing it to just over $1 billion by 2005. So far, so good. But then you condition those on what I think you call performance targets. And here's where I begin to have reservations and doubts, Mr. Secretary. Now, I believe that the United States should commit, at a minimum, to the upper range of the funding levels you've proposed independent of what I think are artificial performance targets. As you know, Nobel economist Joe Stiglitz has said that—and he used to be the Chief Economist for the World Bank and Chairman of the Council of Economic Advisors, I have great regard for Joe—that even if the United States doubled its IDA contribution, we could be confident that the money would be well-spent absent performance targets. His point is that the World

Bank has already come a very long way in evaluating successes and failures and in using that information to improve development assistance. As a result, a large number of viable development projects go unfunded for lack of adequate donor support.

Of course, we should look to benchmarks for progress as we allocate funds to all of the MDBs, but here's where I'm concerned. I'm concerned that the performance target initiatives will encompass areas that are inherently difficult to measure and do not lend themselves to use as annual benchmarks. For example, you've rejected school enrollment as an appropriate metric in favor of outcome-oriented measures such as ability to read and write. Well, I share your desire to focus on outcomes, but one only needs to consider the painfully slow process of seeking education performance measures in the United States of America to recognize the very practical problems with doing the same in the world's poorest countries.

Rather than a finely-tuned matrix of empirical measures, I fear that what we will really get is a highly subjective judgment from Treasury officials about whether a target has been met or not, something akin to the OMB scorecard for agency performance that was unveiled in this year's budget. And with Mitch Daniels desperate to find cost savings around every corner, there will be enormous pressure to keep U.S. funding for IDA as close to the baseline as possible. And so while I do not dismiss and absolutely reject the use of benchmarks or performance targets entirely, I have great reservations and doubts and concerns. I'm willing to await the details before final judgment, but you're going to have to convince me on that one.

Let me go very briefly to the so-called international bankruptcy regime, and I'll only take a minute. I've been a long-time advocate for the creation of a debt workout mechanism. I've put provisions in the 1986 and 1988 trade bills along those lines. Argentina has demonstrated, once again, such a need. There's always a country almost every year. But I think now we have some momentum. Ann Krueger is the new Deputy Director of the IMF, and she has been advocating some type of bankruptcy mechanism.

Now I know that John Taylor—is John here today? No.—made some recent comments, and it would appear that his comments are reflective of the Treasury's, that you part ways with the IMF on how best to structure the proposal, not how to get to the end, but on the means to the end. I'm eager to move the discussion beyond the academic and toward a concrete plan. I think it's very important. And perhaps it might be desirable to advance this through legislation too, but not necessarily. It's something I would dialogue with you on, and with the Chairman, of course. I thank you very much, Mr. Secretary.

[The prepared statement of Hon. John J. LaFalce can be found on page 39 in the appendix.]

Chairman OXLEY. The gentleman's time has expired.

The Chair is now pleased to recognize the Chairman of the International Monetary Policy and Trade Subcommittee, the gentleman from Nebraska, Mr. Bereuter.

Mr. BEREUTER. Mr. Chairman, thank you and thank you for scheduling these hearings. And Secretary O'Neill, thank you for your appearance today. I have a particular concern I didn't bring to your attention today, but I want to recognize and state my respect for you and the leadership you're bringing to the Department, and may I also mention preliminarily that our subcommittee recently held a hearing on IMF as it relates to Argentina, and Secretary John Taylor was very cooperative and very helpful to us in that hearing, and we will shortly be having another hearing with critics and supporters of current IMF policy, and if I have the time and questions, I'll pursue a few things in that area.

I wanted to mention to you specifically though today that last year, the subcommittee not only passed important legislation related to the regional multilateral development institutions, specifically the Asian Development Fund and the International Fund for Agricultural Development, but also passed policy changes and on a wider variety of the regional development banks.

For tactical reasons, important tactical reasons, we have linked that legislation with the reauthorization of the Export-Import Bank legislation, wanting to bring them to the floor at the same time. We passed those on October 31st of last year. But, because of authorized or unauthorized threats of veto from Treasury because of problems between the Export-Import Bank and the Treasury Department on the use of Eximbank's Tied Aid War Chest transactions, we've been at an impasse.

Last month, I was finally successful in bringing together Treasury, Export-Import Bank officials and the White House representatives to see if we can't find some resolution to what I think has been an arbitrary and inappropriate position and statement on the part of Treasury officials early in last year on several projects.

I think they violated their own vaguely described criteria, and we have to have some changes, in my judgment. I understand that every Administration would like to have a clean, straightforward reauthorization under most circumstances, but I think reforms are really essential in this area. The subcommittee has worked well on trying to bring itself to a conclusion that was acceptable to all, and I think we have succeeded, but I do need to have a resolution on this issue. Just because of things that have happened in the last few weeks, I believe it is now much more difficult, in fact, to pass an Export-Import Bank reauthorization. We've already had it extended to March 31st through an appropriation bill, but I know I will resist, and I think this Committee would resist an end run around the Committee through the appropriations process because we really need to have some reforms. And I would hope that we might shortly find a resolution.

Mr. Secretary, I sent you a letter on this subject on February 15th. To my knowledge, we haven't received a reply. However, we are having significant problems in opening our irradiated mail, so if you reply, please don't respond by the U.S. Mail, because we're still getting Christmas cards and our people are getting sick as a result of opening irradiated mail now. So fax, personal delivery or whatever, but we need to have a solution on this.

I conclude, Mr. Chairman, by mention to the Secretary that I understand we'll be expecting a significant reauthorization legislation request on other issues this year from the Administration, African Development Fund, the Global Environmental Facility, and most controversially and most significant in terms of dollars, the International Development Association. You will need the Committee's cooperation and assistance on this, and we will need yours.

Thank you, Mr. Secretary, and thank you, Mr. Chairman.

[The prepared statement of Hon. Doug Bereuter can be found on page 36 in the appendix.]

Chairman OXLEY. The gentleman's time has expired.

The Chair is now pleased to recognize the Ranking Member of the aforementioned subcommittee, the gentleman from Vermont, Mr. Sanders.

Mr. SANDERS. Thank you very much, Mr. Chairman.

Mr. O'Neill, welcome and thank you for being with us. I just very briefly in my opening remarks want to touch on three issues that I hope you will be responding to in questions later on. That is, number one: the IMF; number two: the Export-Import Bank; and number three: the huge trade deficit this country currently has and its impact on manufacturing, something I suspect you know something about.

Mr. Secretary, needless to say, in the United States and throughout the world there has been a lot of concern about globalization and the impact that globalization has on people in the developing world as well as working people in this country. My particular concern is that one of the aspects of globalization, it seems to me both in the United States and abroad, is that it creates a growing gap, an increased gap between the rich and the poor. In the United States today we have the most uneven distribution of wealth and income of any major nation, in which the richest 1 percent of the population owns more wealth than the bottom 95 percent. I see that as a very, very serious problem, and that phenomenon exists increasingly in developing countries, as well, where the elite of those countries own enormous wealth, while the poor in many cases get poorer.

Second, as I think you know, I just returned from a trip to Russia which was in the unfortunate position of having been guided in its transition by the IMF, among other institutions. And some gentlemen in Russia said, "Well you guys were smart, you ignored your economic advisors. You sent them to Russia." The result is, in many ways—not totally I understand—but, has been a disaster among men in Russia. As you may know, in the last 11 years, life expectancy has declined by 10 years, which is a-historical, never happened before in the history of the modern world. You have senior citizens, older people, living on $25 a month in pensions. We saw in Moscow, which is the wealthiest area of the country, old people begging out on the streets. It was not a pleasant site.

The IMF also apparently has created disasters in Asia, and according to some people at least, has done a very poor job in Argentina. According to a recent op ed in the *Wall Street Journal*, the IMF's quote was: "30 programs in Argentina contributed to the collapse of tax receipts, sky high interest rates to compensate for currency uncertainty, and investments stand still and deadline riots and the fall of the government. The IMF's policy pattern is as clear in Argentina as in previous collapses around the globe. It gives countries bad economic advice, then lends heavily to them, allowing them to waste the new funds, and watches as the government's popularity plunges."

I would hope that you would agree with me that the IMF is an institution in desperate need of some structural adjustment itself. I can remember several years ago at a subcommittee hearing we had the U.S. representative to the IMF before us. I think we had to threaten a subpoena to get her, as a matter of fact, but she was there. And I asked her about some of the votes that had taken place in the IMF, and later on she told us, to my amazement, is there are relatively few votes, that kind of consensus agreements are worked out and it seems to me, for the well-being of this country and for developing countries, that there needs to be infinitely more transparency, not quiet back room dealings. Very often, the people who are most effected by these austerity measures, who see education and health care budgets cut, read about it in the newspaper. In a sense, these measures are forced on their governments who will not receive loans unless the governments go along with it.

So, in terms of the United States, the U.S. has a huge role in the IMF, and if we are interested in winning the support of poor people around the world, developing countries, I don't think we want to be part of a process which imposes austerity programs on those people which often cause a great deal of suffering among the poorest people in those countries, so maybe we'll talk about the IMF later.

Second issue——

Chairman OXLEY. The gentleman's time has—can you get to that in questioning?

Mr. SANDERS. Very briefly, if I can. Export-Import Bank, as you may know, Mr. Secretary, the Export-Import Bank approved a $300 million loan for Enron in a project in Dahol, India, to build a natural gas power plant, even though the World Bank repeatedly refused to finance that project because it was not economically viable, so we'll want to be talking about Export-Import Bank, their loans to Enron, and in general, the non-productive work that that agency sometimes does. Thank you very much.

Chairman OXLEY. The gentleman's time has expired.

We now turn to the Secretary of the Treasury, the Honorable Paul O'Neill. Welcome back to the Committee, Mr. Secretary. It's good to have you back, and please feel free to begin.

STATEMENT OF HON. PAUL H. O'NEILL, SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Secretary O'NEILL. Thank you, Mr. Chairman, Congressman LaFalce. We prepared a fairly long statement which I'd like to have included in the record, which tries to summarize and then develop in some detail the things that we've been doing over the last 13 months.

Chairman OXLEY. Without objection, the full statement will be made part of the record.

Secretary O'NEILL. Thank you very much. And, Mr. Chairman, with that, what I'd like to do is make just a few opening remarks, and then turn to your questions. Thank you for inviting me here today to discuss President Bush's international economic agenda and our efforts at the Treasury Department to advance that agenda.

Before we turn to today's important topic, I'd like to take a moment on something else. You are all Members of the Financial Services Committee and you know how important the full faith and credit of the United States is. You know we're going to reach a debt limit in late March. I urge you to act quickly to permanently increase the debt limit. Delay creates uncertainty that can threaten our economic recovery and undermine U.S. leadership as we pursue the war on terrorism. You may want to come back to this.

But, with that, let me turn to the subject at hand.

When I accepted the job of Secretary of the Treasury, President Bush directed me to meet a number of important challenges. One of those challenges, one I take very seriously, is our Nation's role in international economic development. The President's message to me was very clear: if we care, and we have simple respect for human dignity, then we must finally deliver on a half-century of unfulfilled promises. We must raise the standard of living of poor people living in the world today.

The leaders of the free world joined together more than 50 years ago with a commitment to speed the progress in the underdeveloped world. Over those 50 years, we've witnessed incredible feats of human progress. Today, more people than ever before in the history of the world have the opportunity to reap the benefits of their labor and creativity in free markets, and to create wealth. And yet, for many nations, progress has been slow or non-existent. And it causes a question to be asked often, I think, why are so many people still poor?

The nations that have failed lack systems that support the realization of new ideas. Most of the building blocks for progress are not expensive: good government, the rule of law, respect for property rights, a commitment to free markets, and a commitment to peaceful relations with neighboring countries are the essential ingredients. But for many countries, these foundations for development are out of reach. They lack capital, know-how or encouragement from the international community, and in some cases countries have gone down the wrong road because of the policy prescriptions from the international community or perverse incentives that our international assistance programs themselves have created.

Let me take a few minutes to discuss some of the ways we're trying to improve the system. To unleash human economic potential, it is vital that economies have a sound and stable environment to grow and attract private business. Capital is a coward. It goes where it feels secure, and can grow. Cultivating macroeconomic conditions that support growth and attract capital is the job of the International Monetary Fund. Rather than serving as a firefighter for crises, as it has in the past, we believe the IMF should become more like a gardener, nurturing the seeds of private sector growth. Thus, our first task is to prevent the eruption of crises that undermine and reverse growth.

With our encouragement, the IMF is taking steps to strengthen its early warning systems so that it can better preempt crises before they explode. Greater transparency is also fundamental, both on the part of the IMF and its member countries, so that financial markets can discern the true performance and potential risk of individual economies and the system as a whole.

With our support, the IMF is also narrowing the focus of its involvement in member economies. As the IMF has acknowledged, the organization has at times allowed its activities to expand beyond the scope of its primary mission, overlapping with the mandates of the Multilateral Development Banks in areas such as promoting agricultural reform and judicial reform. This has diminished the Fund's effectiveness in pursuing central objectives. We believe the fund should focus on monetary, fiscal, exchange rate, and financial sector policies that lay the macro-economic framework for growth. In addition, we're making clear that there are limits on official support to countries in unsustainable situations that have a history of making bad policy choices and avoiding reform.

Despite several recent incidents, there remains no clear consensus approach for dealing with unsustainable situations, and the uncertainty that remains creates too much pressure for large-scale lending by the IMF, and may contribute to decreased investor willingness to invest in emerging markets. To help reduce this uncertainty, we're working to develop a sovereign debt restructuring mechanism that will provide a more predictable framework for debt workouts. Having such a workout strategy may help reduce the pressure for large-scale financing, and it may also create increase capital flows to emerging markets at lower interest rates.

Let me turn now briefly to the World Bank and the Multilateral Development Banks. As President Bush has said: "A world where some live in comfort and plenty, while half of the human race lives on less than two dollars a day is neither just nor stable." Poverty today remains widespread and deep. It's clear that we can and must do better. Rising productivity is the driving force behind increases in economic growth and rising per capita income. We are urging the multilateral development banks to focus more intently on operations that raise productivity, concentrating on education and health, promoting private enterprise, promoting good governance and opening economies to trade and investment. Productivity is now receiving more emphasis in the debate on MDB policies within the institutions and among the other shareholders. We are also urging the MDBs to establish monitoring and evaluation systems that measure development results.

Private sector development is crucial to economic growth and poverty reduction. MDBs should play a larger role in promoting needed investment climate reform and in channeling technical assistance on project finance to fund viable private sector projects in countries that have adopted core standards for a sound investment climate.

Another significant initiative is President Bush's proposal that up to 50 percent of the World Bank and other MDB funds for the poorest countries be provided as grants rather than as loans. It simply doesn't make sense to pile more debt on the poorest nations of the world. Those debts have to be repaid by taking from people who live on less than two dollars a day. How can such new debt loads help them develop a vibrant, self-sustaining economy? It would be irresponsible to assume that some time in the future, donors will be willing to finance another massive international debt reduction program for them. We continue to negotiate with our international partners to achieve a successful agreement on this initiative.

While increased global trade is vitally important to the U.S. economy, it's also the cornerstone of our development efforts. Increased trade raises the standard of living of people here in the United States and in the rest of the world.

Bilaterally, the United States is negotiating free trade agreements with Chile and Singapore and seeking meaningful commitments from countries seeking to join the WTO. Regionally, we're working hard to create a Free Trade Agreement of the Americas and the Doha Agreement last November gives us the opportunity to expand trade globally. President Bush feels that U.S. leadership is essential to meet the challenges of international development. The United States should be a locomotive of global economic growth and a champion of economic development in those parts of the world that have lagged behind. Economic growth produces peace, stability and democracy. These are important national goals that have gained significance since the September 11th attacks and the start of our war on terrorism.

Mr. Chairman, I'd be happy now to take the questions of yourself and your committee Members.

[The prepared statement of Hon. Paul H. O'Neill can be found on page 44 in the appendix.]

Chairman OXLEY. Thank you, Mr. Secretary. Let me begin by asking you a question that started really yesterday with Chairman Greenspan's testimony in which he indicated that he did not see a large spillover effect on the U.S. economy from the situation in Argentina and Japan. He also stated he did not see much potential of contagion for surrounding countries or regions in either case. You may have seen some press reference to that. Would you care to comment on that particular statement?

Secretary O'NEILL. Of course, I always agree with the Chairman, or almost always.

Chairman OXLEY. He indicated you served on the same board at Alcoa.

Secretary O'NEILL. That's right. We've been associates and colleagues for more than 30 years now, and it's true that we do very often agree with each other. To the specific question of direct effects on the U.S. economy from Argentina and Japan, I agree with him, though I did not see the press accounts. But I would go on to say this.

In the case of Japan, they've now had 11 years of average growth of 1 percent, when their economic potential is something on the order of 3 percent. And while I think it's very hard to draw a connection between their slow rate of growth over this period of time—three recessions in the last 11 years—it is nevertheless true that our world is now so fundamentally interconnected that when a major economy like Japan, which is the second largest in the world, runs at significantly less than its potential, it has an effect in two different important ways. First of all, it has a material effect on the living conditions and the average income of the Japanese people themselves. I think that's the most important and telling. But second, it means that their economy is creating less capital that could be used for the purposes of economic development in the broader world at large. And so, I think it is very important that all economies, especially the very largest ones, act as locomotives for the rest of the world so that we can together help to overcome the problems I've addressed in my prepared statement of so many billions of people still living in the world today with income levels that are so small— that it's almost impossible to conceive being able to live on less than a dollar a day, which is what billions of people are doing.

Chairman OXLEY. I want to get back to Argentina perhaps a bit later, but in my opening remarks I specifically mentioned Turkey, and I had the opportunity to visit there last June, I believe it was, May or June right at the time that Gemal Durbesh had been brought back from the World Bank to become the finance minister, and I must say I was most impressed with him. Could you give us a brief update on where Turkey is in their efforts to try to get their economy back on track?

Secretary O'NEILL. I'd be very happy to do that. Turkey is a very interesting case, because when I was here last year, I would say most of us considered Turkey and Argentina to be in the same place. They were both having enormous problems. They'd had multiple IMF programs. And I think shortly after I was here last year, the IMF told to Turkey that there were certain preconditions that it had to meet before more money was sent. President Ecevit and Minister Dervis set out to get some very difficult legislation through their equivalent of our Congress and only after they had met the conditions that were suggested to them,— which frankly seemed very sensible, and were not about impoverishing the country or squeezing social spending,— the money began to flow.

And while I think they still have a very difficult economic situation, they are markedly different from where they were this time a year ago, or even where they were nine months ago, in spite of the fact that their tourism industry evaporated after September 11th for a period of time. President Ecevit was here about 6 weeks ago, and I had an opportunity to spend some time with him. I was very impressed by his articulated determination to keep on the track of a sustainable economic position for his country. I was very impressed by his quickness of mind and command of the issues. So this is not a case where just Minister Dervis is a very impressive person. The president, himself, is a very impressive person, and I thought some cabinet members that were with him were equally impressive in their understanding of what needed to be done and their apparent commitment to do it.

Chairman OXLEY. Thank you. My time has expired.

The gentleman from Vermont, Mr. Sanders.

Mr. SANDERS. Thank you, Mr. Chairman.

Mr. Secretary, I would like to focus on two issues at this point; the Export-Import Bank, and the trade deficit. In terms of Enron, the Export-Import Bank approved a $300 billion loan for an Enron-related project in Dahol, India, to build a natural gas power plant even though the World Bank repeatedly refused to finance this project because it was not economically viable according to Human Rights Watch, Amnesty International, and other groups. Enron subsidiaries paid local law enforcement to suppress opposition to its power plant, in which they arbitrarily beat and arrested dozens of villagers.

I wonder if, when I'm finished, if you could give us some information on that, or get some information to us on that.

Second of all, in terms of Export-Import Bank in general, the ostensible purpose of the Export-Import bank is obviously to create American jobs, right? That's its theory. Yet, some of the major recipients of Export-Import subsidies, Halburton, AT&T, Bechtel, Boeing and General Electric, have laid off hundreds of thousands of American workers over the last 10 or 20 years. So the average American I think would say, why are we pouring and subsidizing some of the largest corporations in the world, very profitable, who, in fact, have announced to the world that they're shutting down plants in the United States and moving to Mexico and China, and we are giving them subsidies in the name of job creation. I think on the surface it is insane and I wonder if you would comment on that.

Third point I would like to ask you to comment on. In your remarks you talk about trade, promoting global free trade, and you say, and I quote: "trade has created million of jobs that pay above-average wages and has helped promote the global growth upon which America's own growth and prosperity ultimately depend." Yes. No question. Trade has created millions of jobs. Yet, there is another side to that equation. We have a $400 billion trade deficit. Speak to the people in the steel industry, speak to the people in the northeast kingdom of the State of Vermont, speak to the textile workers. When you have a $400 billion trade deficit and $100 billion trade deficit with China, the reality is that China is now our 51st state in our manufacturing sector. Every major corporation in America has gone to China that pay people 20 cents an hour, rather than hire American workers at a living wage.

Now, I am not against trade. Trade obviously works when it is based on fair trade. I would hope that you will speak and raise the issue of what I consider to be a fiasco in terms of our trade policies which have impacted millions of American workers. Mr. Secretary, a young person without a college degree who goes to the job market today is earning 20 percent less than was the case 25 years ago, because there aren't manufacturing jobs there; there are McDonald's jobs there. And I know that you are smart enough to understand this, and I would hope that we could go beyond the rhetoric the trade is just great. It ain't great when you have a $400 billion trade deficit, OK, and we've got to deal with that issue, and it's not talked about enough. So that's enough of my rhetoric. I would appreciate your response to those issues, please.

Secretary O'NEILL. Thank you very much, Congressman. To the first issue of Eximbank intervention or program support for the investment in India, I don't know anything about this, but from reading the newspaper accounts, I understand this was done sometime in the Clinton Administration 3 or 4 years ago.

Mr. SANDERS. Right. It's certainly not a new policy, no.

Secretary O'NEILL. Right. This is not something that the Bush Administration had anything to do with.

Mr. SANDERS. Oh, but they supported it, and they're actively involved. It's bipartisan, sir, bipartisan.

Secretary O'NEILL. I'd be happy to find out from the Eximbank what facts they looked at in making a decision.

Mr. SANDERS. I would appreciate it if you could get back to me. Talk a minute about Export-Import, the general philosophy on the issue that I raised.

Secretary O'NEILL. You know, I do think the Eximbank is there to support job creation and protection for companies in the United States. You know, I didn't honestly come prepared to defend the Eximbank today in great detail. But I'm sure there must be thousands of programs that they have supported over time, not only for big firms, but small firms. As a matter of fact, I think the issue of contention that Congressman Bereuter was speaking about had to do with a fairly small firm or transaction,— it was a very small transaction involving a company from his district.

Mr. SANDERS. That's all true. But, does it make sense to you that if General Electric announces to the world that it is part of their program, they're going to be moving companies to China and to Mexico, and then they come in and ask for an Export-Import loan, does that make sense to you?

Secretary O'NEILL. I don't know. I guess I'd like to look at the circumstances. Maybe we can couple these together and I can talk to you from personal experience. When I was in my previous incarnation, or previous two, I made investments in China. I didn't make investments in China so that I could pay people, as you said, 20 cents an hour and be in competition with U.S.-based industry. I made investments in China because it was a market of 1.2 billion people and I thought my duty to my shareholders was to make sure that they participated in world economic growth, and I wanted to be an on-the-ground supplier of valuable goods in the Chinese market. And I did the same in 36 different countries, Congressman. It was not so that I could hurt my workers in the United States, which numbered 50,000 and I more than tripled in the time I was there. It was so I could make good on the idea of being the very best company in my industry everywhere in the world.

Mr. SANDERS. Look, I respect that, but there are many companies who have done some very different practices, laid off American workers, moved to China, no question about that. Maybe you and I can discuss that at some point.

Last question——

Chairman OXLEY. The gentleman's time has expired.

Mr. SANDERS. Trade deficit $400 billion, $100 billion with China——

Chairman OXLEY. The gentleman's time has expired.

The gentleman from Nebraska, Mr. Bereuter.

Mr. BEREUTER. Thank you, Mr. Chairman. I wasn't going to bring up the Export-Import Bank again, but I would say to you that when Treasury steps in and reverses the decision of the Export-Import Bank on two transactions, one of which has, by the company's estimate, follow-on sales of $100 million a year on a manufactured product, this is not a small issue for me or my constituents.

I want to go, however, to two questions, Mr. Secretary. One, I don't expect you to be necessarily familiar with the details of this, but there's a small institution, relatively speaking, International Fund for Agricultural Development. They are not reimbursed for their contributions to the highly indebted countries, the HIPC Initiative. All the other development institutions are.

I sent a letter to Deputy Assistant Secretary Schurs February 4th, because he or someone from the department was headed for a donor's conference in Rome on February 7th. And I know that the U.S. was going to discuss this issue. At least it was on the agenda, as to why IFAD cannot be treated like the other multilateral institutions with respect to HIPC.

Second, I think it's actually courageous and perhaps very good policy to move part of the loan activities of the World Bank and other multilateral institutions to a grant basis. There will be a lot of questions raised about it in Congress, but at least it's an issue that has reason for support. And I'd like to know the reactions that you've received from other countries that, to this point, have not at least appeared to be supportive.

Finally, I want to share a story with you about the IMF. How at times I think their policy can actually be very counterproductive and how I think that the social costs created by some of the conditions, entirely appropriate conditions, have to be better met in coordination with the World Bank or the regional development banks.

I chaired the Asian-Pacific subcommittee for 6 years, and I was chairman during that period of time when the Asian financial crisis started, which began, as you know, in Thailand. Thailand had a lot of problems in bank regulation and incestuous relationships between the private sector and commercial and public banks. Crony capitalism, in short, but they were not a fiscal basket case by any means. They had fiscal resources.

Then it spread to the Republic of South Korea. They also did not have fiscal problems, but when Senator Roth and I met with the finance minister in Seoul, who was also, I think, the deputy prime minister, we asked him if he was considering accelerating public works projects, given the fact that they had the fiscal resources, financial resources to do so. Port development, highway constructions, things that were ready to go. And he said, "Oh, I don't have that option under the IMF Directive." Even though they knew they were going to have unrest on the streets, high unemployment rates at a time when they could have financed it early-on in Thailand and in South Korea, they were told they were not allowed to do that. I think that is exactly counterproductive advice, and, of course, soon they did have fiscal problems and they had unemployment problems. So there is one example.

You could go back to what happened in Latin America on the advise that was probably appropriate in a macro-economic sense, but not accompanied by the cooperative work of the World Bank, or the international development institutions in a regional nature. So I remember how the Treasury, in a previous Administration, actually led the effort to give bad advice through the IMF to Thailand and the Republic of Korea. And then to top it off, when Thailand got in deep trouble, the United States, its ally, was not there to help them. They got money from Hong Kong, they got money from the PRC, and from many countries, but we weren't there.

Secretary O'NEILL. Well, I appreciate your questions on the first issue. Bill is here with me, and we will get you something on the agricultural development funds.

Your other two questions are wonderful questions. On the response that we're getting to proposing that we move from loans from the multilateral development banks to grants, many of you know we had some initial reactions that said that this was a very bad idea. And as we prepped them, the people who had voiced their opposition, tell us their reasons. One reason was "Well, these are banks and banks don't make grants,"— didn't have anything to do with what's the right thing to do for world economic development. It was institutionally couched. And when people saw that wasn't a very useful argument,— I mean, they were embarrassed after a while to make that kind of an argument,— they started saying more directly what I think they really thought, which is "We're really worried that you're using this as a way to reduce U.S. financial participation for helping the low-income countries to develop."

And, as was noted by the Chairman, in the President's budget, we've proposed that we increase the amount of money that's available for these multilateral institutions to make the point that this is not about being stingy, this is not about cutting back, this is about getting performance and getting results for our money in terms that are meaningful to the people in these countries,— which is to say that their living standard goes up, not that we just send more money, but that something very important happens.

And in the last couple of months, I would say we're making more and more progress with other countries on this issue to the degree that the Development Minister from Norway, Minister Hilde Johnson, has put forward a proposal that says we should identify things like aid to post-conflict countries, aid for HIV prevention projects, aid for countries that have average incomes of less than a dollar a day,— and we would say aid for primary education,— that these things should be done as grants, they should not be done as loans. And the response now has improved, and that would make a substantial difference in the level of money distributed through grants instead of loans.

I won't tell you which one, but one of the European finance ministers said that was all fine as long as the total didn't exceed 10 percent,— to which I said, tell me why 10 percent. And if you agree that these human-driven ideas are the right ideas, why do you say 10 percent is as far as we can go? There's not a good answer to that question. And so I would say we are making progress. It's slower than I would like, but we are making some progress.

On the question of IMF—and I'll do this quickly, Mr. Chairman, as I see you're looking at the time—I agree with you that the IMF has in the past insisted on some policies that taken broadly and from the point of view of the leadership of a country don't make any sense. We've been working with the IMF over the last year to hopefully cause them to rethink how they relate to the world. Let me just to take a specific area, which makes great good sense to me, where I think we need to change our idea of what's acceptable in the world. For the longest time, I would say for 50 years, through our practice and our words and our loans, we have basically taught the developing world that if you're a low-income country, it's OK to be,— in fact, we encourage you not to be an investment-grade country. What that means is that your debt is very, very suspicious and you have to pay a very high interest rate in order to get people to take your sovereign paper. Now if you think about it, it is the worst of all possible things to say to people who are living on less than a dollar a day, that you get the treat of paying 18 or 20 or 25 percent interest rates on your sovereign debt, because we're encouraged to do that by the development community. It is a very bad idea.

And I think the only reason that we've permitted this to happen is because we constantly forget who pays the interest rate charges on sovereign debt. The people who make and live on less than a dollar a day pay it. The government doesn't have any money it doesn't apart from the people. And so we've been working to change the standard of what it means to be a developing country and to say therefore we should not ask developing countries to take more debt burden, which means the interest rates they have to pay go to 20 or 25 percent.

Chairman OXLEY. The gentleman's time has expired. Before I yield to the gentleman from Massachusetts, Mr. Secretary, there was an article in the *Wall Street Journal* talking about the same issue you were talking about, particularly Norway's minister of international development and the 10 percent issue. You were more outspoken in your speech. Let me quote from the *Wall Street Journal*:

"Mr. O'Neill's response was scornful. 'Europeans say more than 10 percent is too much,' he told a couple of hundred guests at the Institute for International Economics and Center for Global Development. 'I say the hell with it. Tell me a good reason.'" So I think we know where you stand on that issue.

The gentleman from Massachusetts.

Mr. FRANK. I thank the Chairman. Without a little scornfulness, Mr. O'Neill, people might not have recognized you, so I'm glad that he gave us a little context.

I was pleased to see you single out aid to Afghanistan in your statement. We obviously have a moral obligation. I think—like everyone else here, I agreed with what we did there, but having, in self defense, engaged in that military action in which tragically, innocent people got killed and I do wish the Pentagon was a little less grudging in acknowledging that and a little more careful about it, but it's inevitable. Obviously, we have a moral obligation to help rebuild, but I'm a little troubled.

What's our contribution for the first year to the Afghan reconstruction fund?

Secretary O'NEILL. I've forgotten.

Mr. FRANK. I'm told it was about $200 million, and the total we're talking about here is, well, I just heard that it's going to cost us $30 billion a year for the war, and I'm troubled by the 150-to-1 disparity. I think frankly we are not meeting our moral obligation as a Nation to provide more funding. Obviously, you don't want to provide money that people can't use, but everything I read says we have people who are hungry, we have police officers and others not being paid, and I was impressed, Mr. Secretary, and I appreciate the passion of your rhetoric about the unsustainability of a world with such enormous disparities where people, through no fault of their own, are living so degraded.

To be honest, I think we can do more, and I like the direction that you talk about going in. But let's start with Afghanistan. There was really no moral justification for a 300-to-1 disparity or 150-to-1 disparity. I have trouble with my math. Between $30 billion and $200 million, in terms of what we contribute.

Now let me say with regard to the grants, and I agree, and I've read some of these arguments. One of the ones that seemed to be silly to me was well, if we make it a grant instead of a loan, the country won't have ownership of the program. I think that's the kind of thing people say when they have nothing else to say. But there is one legitimate question here. And I must say, I appreciate the care with which the Administration has differentiated its approach on the grant versus loan from the Meltzer Commission. The Meltzer Commission was an intellectually respectable operation, but it was far more critical of these institutions than I think that I am, and I believe, I was pleased to see, the Administration was.

So, what is important, and I think that gives rise to some of the fear that this is the way to get rid of these things. The problem, as you know, is that some of the financing that we do for future projects comes out of the reflows, and it would seem to me if the U.S. Government would just commit to making up any gap in financial availability of funds, that would come from the lack of the reflows, we could do away with that and we would have virtual unanimity. Can't we just say that, Mr. Secretary? That we would agree to make up, through an appropriation process, any gap caused by the cessation of reflows?

Secretary O'NEILL. I think the amount of money that we've suggested over the next 3 years stepped up through this performance idea would more than take care of the reflow associated with the U.S. proposal.

Mr. FRANK. Well, I agree, although we do understand that in the first couple of years, the reflows are fairly small, so would there be any objection in principle, or let me put it this way. Shouldn't we, to advance—because I think moving to grants is a very good idea—but, wouldn't it be helpful if we said that we, to the extent that you and I and others can commit people yet to come, that our policy would be that in the future, to the extent that there continued to be a need, we would continue to make up for any loss through the lack of reflows?

Secretary O'NEILL. The concept—I don't see anything wrong with that. I'm not sure about your rules and what that means for 10-year commitment for scorekeeping and——

Mr. FRANK. Well, one thing we've learned is anything we say today we could all undo tomorrow. But it does help, I think, to set the policy. After all, the move from loans to grants isn't binding. It could be undone. But we committed ourselves.

Secretary O'NEILL. I agree with you.

Mr. FRANK. Thank you. Let me then just make the last point. Again, I was struck, and I appreciate your passion on the issue and I think that is appropriate. Part of the problem we have, of course, is—and I guess when you talked about capital being a coward; I love that phrase, I think that's true. Capital is very mobile. Unfortunately, that gives capital an awful lot of sway in the world that it can sometimes beat down other considerations. One of the problems is that when countries are told to do the things that make them investment safe, the money to help alleviate the short-term social pain isn't there and that makes it harder to get these things accepted in a democratic society. Let me cut to the bottom here.

I believe that as the wealthiest Nation in the history of the world, given the way you have framed this issue, even though you're talking about more, we're still not doing enough. We found $48 billion, we're going to find $48 billion over my objection to increase military spending. I think it's more than we needed. But, when we were threatened, we found $48 billion.

I think we could do more with regard to precisely the issues you talk about. Now obviously we don't want to send money where it can't be well-spent, but alleviating hunger, dealing with AIDS, these are precisely the areas you talked about where grants could do some good, would you not agree that the world could absorb a significantly higher level than we're talking about, and can't we try to find somewhat more than we are doing? And that includes, I believe, just to close, Mr. Chairman, further pressing the international institutions fully to fund the HIPC. I think we as a bilateral effort have done more than they've done. We're not talking about an enormous amount of money; maybe it's billions more, but I think it would go pretty far. And as far as the rest of the world, you know, they've been critical of us because we're not doing enough; let's call their bluff, let's see them and raise them and see what they do in this poker game.

Chairman OXLEY. The gentleman's time has expired.

Does the Secretary wish to respond?

Secretary O'NEILL. Maybe just to say one thing. One reason for wanting to be very, very forceful with the IMF and the World Bank in developing performance measures is so that we can create a basis for saying to the American people, not only should we do more, but we can assure you we're going to get real value for all of the money that flows through these institutions. My own view is that as we can demonstrate that we know what we're doing, we can make a case the American people will believe in and the Congress will be able to act on.

I've asked Jim Wolfensohn of the World Bank to do something, which he's in the process of doing and hopefully we'll have before the Monterey conference, which is to write a report that learns the lessons of the last 50 years and says precisely and specifically what has worked and why it has worked. And even more precisely and specifically what hasn't worked and why it hasn't worked. Because I believe we have done a pitiful job of learning from experience, and as a consequence, our Government and other governments have not been believable when they say that they know what they're doing in this area of economic development. After 50 years, not only are people living on less than a dollar a day, there are places in the world where the living standard is worse now than it was 50 years ago when we began this effort. I believe we can do better, and then I believe we will command the resources to expand and improve what we're doing.

Chairman OXLEY. The gentleman's time has expired. The gentlelady from Illinois, Mrs. Biggert.

Mrs. BIGGERT. Thank you, Mr. Chairman. Mr. Secretary, in wake of the terrorist attacks on September 11th, I think world leaders have been examining and reexamining the whole issue of global poverty and the fact that it does provide a breeding ground for terrorist movements. Some have argued for a renewed effort by developed countries to commit .7 percent of the GNP to global assistance and it certainly is a standard that neither we nor our allies can begin to meet. So could you take a moment and share with us how you feel the events of September 11th have changed the focus of our international development policy?

And could you talk about U.S. assistance to the World Bank and the multilateral banks within the context of the battle between democracy and these radical groups?

Secretary O'NEILL. Well, I think if you go back and look at what the President said at the World Bank in July, you will find that he said how important it is that we fulfill our responsibility in the broader world to work on meaningful economic development. So I would say, yes, all of us were affected in lots of different ways by the events of September 11th. I don't think the President's view, and frankly my view, of the importance of working on these issues was changed in a marked way by September 11th. I thought for a long time, it's not worthy of civilized people who live like we do not to be concerned and making some progress in helping other people to improve their living standards.

I think it is also true that, as I was saying earlier, that the IMF and the World Bank have fallen short of what they can do, and therefore there is a real need for a reassessment and redirection and realization of turning rhetoric into reality for people on the street.

Mrs. BIGGERT. Well, certainly you know this Committee has played a role in the formulation of the Patriot Act and certainly looking at money laundering, and that's been linked again to the terrorist activity and trying to suppress them.

What role then do you think that the IMF should play in the money laundering issues?

Secretary O'NEILL. This is a subject that we've worked on with Horst Köhler and his people at the IMF, and they've been very responsive to our request in being supportive and helping to encourage the association of all the countries in the IMF with our efforts on a worldwide assault on terrorist finances. We've been talking with them. As a matter of fact, I had breakfast with Horst K̈hler and Ann Krueger a week or 10 days ago and talked about them becoming a clearinghouse where countries would report on the actions that they've taken to establish appropriate mechanisms, and I think we'll get that done fairly quickly. And to connect back to your earlier question about how we're changed by the events of September 11th, I must tell you it never occurred to me when I came here that I would be spending a significant fraction of my time designing systems to interdict and confiscate the funds of people who would do the horrible things that were done on September 11th.

I would also say to you, I think we've done a good beginning job of connecting the world and the institutions of the world to help us in this worldwide fight. In that regard, on Sunday morning I'm beginning a 5-day trip to the Gulf states to meet with the leaders of the Gulf countries to work with them to further tighten our ability to deal with terrorist financing. This is not a finished piece of business. We're in the early stages.

Mrs. BIGGERT. Right. Thank you, Mr. Chairman.

Chairman OXLEY. I thank the gentlelady. The gentleman from Texas, Mr. Gonzalez is recognized for 5 minutes.

Mr. GONZALEZ. Thank you very much, Mr. Chairman.

Good afternoon. My question has to do with NADBank, which is headquartered in my district, and for the past few weeks or months there's been discussion from Treasury about plans that would significantly restructure it and narrow its focus. My concern or course is great. Our problem has been, Mr. Secretary, that we have not been able to obtain from Treasury anything in writing as to what the proposal consists of. So, I would ask you today if you would provide me with that within, let's say, the same time next week. Do not mail it, that is true; email or fax. But it's my understanding that we have not been able to obtain anything that specifically outlines what Treasury has in mind, and further any time line.

And my second request would simply be, I know there would be discussions in Mexico, and prior to any finalization of any agreement with Mexico relating to NADBank, could you again provide me, prior to finalization, the specifics. And when I say, prior, you know, what would be appropriate, I would just simply ask you to put yourself in my shoes as to what would be that appropriate courtesy. And that's the only thing I have right now is NADBank because that's still a very hot issue, when I get back this weekend, as a matter of fact. Thank you.

Secretary O'NEILL. We'll be happy to do that.

Chairman OXLEY. Thank you, Mr. Gonzalez. The other gentleman from Texas, Mr. Paul is recognized for 5 minutes.

Mr. PAUL. Thank you, Mr. Chairman, and welcome, Secretary. I'm glad that we're here talking about reform of the IMF. Of course, my belief is it's probably beyond reform, and that someday we might look at a more appropriate position on the IMF, and that is just for us to get out of the IMF. I have never seen anything that can morally justify our participating and taking money from poor people in this country to pump into the IMF. I've never yet seen any economic benefit come from the IMF, and I have not yet found anybody who can give me constitutional justification and authorization for us to belong to an international organization which serves special interests.

I've never had a constituent in my district come up and say: "Ron, I really want you to vote for the IMF funding this year." It has never happened. I'll bet it hasn't happened in anybody's district. But we do get lobbied for it. We get lobbied for the IMF appropriation by the banks and large corporations. So there must be a special reason they come to us and ask us for this appropriation and for us to stay in the IMF, especially in the midst of a crisis.

You mentioned in your testimony that you would like to head off these crises, but I don't see how that's going to work either because sometimes when there are maladjustments in an economy, the crisis is really the market telling you you'd better do something. If there's something wrong with currency balances or imbalances, then you really need a crisis.

But to try to prevent this by micromanaging, you get into a situation where you're becoming the biggest economic interventionist conceivable. So I think we're more or less trapped.

But I do have two brief questions. You favor debt relief for some of the Third World countries. Why is it that we always have to appropriate that money? You know, if they owe us the money or we loan them the money, why don't we just say, you don't have to pay us? It obviously, or somewhat implies that this money goes to a corporation or to a bank and that's why they lobby us for it. They can't pay it anyway, so just relieve them of it, but don't appropriate the money. But, we always have to appropriate the money.

Now, I have a quick question on the Exchange Stabilization Fund because it works so closely with the IMF. I believe the Exchange Stabilization Fund has more than $35 billion, which is more or less a slush fund, and it can come to the rescue, along with the IMF, to bail out these large corporations and the banks. I have a bill that would make the Exchange Stabilization more responsible, whether they are dealing in gold, or whether they're participating in a bailout, why can't they do that like it should be done through a direct appropriation or direct approval by Congress. Would you support something along that line where Exchange Stabilization Fund would be more responsible to the Congress?

Secretary O'NEILL. Let me start with the broadest question that you asked about the IMF. As I've already testified, I think there is a need for reform of the IMF and the World Bank. I think there's a very good case to be made for U.S. participation in the IMF and in the World Bank that goes directly to the self-interest of the people of the United States. It is evermore true that the world is interconnected. The affairs that were remarked on earlier—when Thailand and Malaysia and that part of the world, Korea, saw a rolling financial collapse—was not of transient interest to the people of the United States. They may not have known it and they may not have understood it, but when the rest of the world verges on losing its position as a market for U.S. goods, believe me, that's a real issue for U.S. farmers, because a huge part of the product of our great farm community goes offshore, and it's true of lots of our other goods.

And so I think we have a decided, clear interest in the economic improvement of and stability in the rest of the world. And saying that, I would also join you in saying I don't want U.S. taxpayers' dollars to be thrown away. I want them to be used for leverage to create more stable conditions, so that those markets that we are ever—increasingly dependent on are there and they're stable and they pay good prices for our products. So I think there is a very good reason to have these organizations.

Chairman OXLEY. The time of the gentleman's expired, but you certainly may continue.

Secretary O'NEILL. May I just say one word in response to his Exchange Stabilization Fund question. In the 13 months that I've been at the Treasury, we have not used the Exchange Stabilization Fund to bail out anyone. And the flexibility that exists in the Exchange Stabilization Fund has been around for a very long time. In reviewing the history of the use of the fund, I think almost without exception, it has been used for a good public purpose. I'd be happy to discuss individual instances with you if you think there's some evidence to the contrary. But I do think that in a world that can turn on a dime, it makes sense for Administrations, both Republican and Democrat, to have some flexibility to respond to crisis conditions. And so I think the Exchange Stabilization Fund has served us well as a country, and I would hope that we don't put restrictions on it that make it more difficult to act when we must act in a hurry.

Chairman OXLEY. Thank you, Mr. Paul.

The gentleman from California, Mr. Sherman, is recognized for 5 minutes.

Mr. SHERMAN. Thank you, Mr. Chairman. There are those who think that the war on terrorism is just an overblown rhetorical flourish. I hope they're wrong, because Iran and Iraq are right now trying to develop nuclear weapons. If they're successful, I believe they'll smuggle them into this country, and I believe that the equation is simply millions of dollars flow to the Iran or Iraq regimes this decade and that leads to millions of dead Americans next decade.

But right now it seems as if we're doing business as usual with the IMF and the World Bank. Iran has received $232 million from the World Bank, $145 million for a "sewer system" and we at least opposed that, and $87 million for health and nutrition which we have not really bothered to oppose. Now you can say health and nutrition, these are wonderful things, but what if an American, through an intermediary, had sent $232 million to the Nazi Regime, and said well don't prosecute me for treason, here's a letter from the Fuhrer that says the money is going to be spent on sewers and health care systems.

When you look at the IMF, Iran has borrowed $530 million, Syria another $100 million. Now we're told they're simply borrowing back their own capital, but look at the incredible benefit they're getting. They are members in good standing of the IMF, but they don't have to sacrifice liquidity, they get their money back. Imagine a partnership where some partners have to contribute capital and others contribute capital and then they get it back.

So clearly, hundreds of millions of dollars of benefit going from the IMF and the World Bank to those that the Administration calls the "axis of evil," but are actually the receivers of subsidies from the American taxpayer. Now we can just make some mild protests, easily ignored, so mild that nobody even heard them. I believe that there are Members of this Committee that don't know that the IMF and the World Bank is distributing funds, dispersing funds due to previously-granted loans to Iran while we speak. Our protest was so soft it didn't even reach this room.

Or we can instead threaten to pull out of these institutions, create a U.S. Bank instead of a World Bank so at least we can tell our constituents that our money is not subsidizing those that the President calls evildoers.

Are we going to continue to do business as usual with these institutions and tell the American public in the surface we're at war with terrorism, and then somewhere deep in the financial pages, our money goes to the IMF and the World Bank, their money goes to the axis of evil.

Have we told our European and Japanese friends that we hold them responsible for hijacking our money and sending it to those who are doing everything possible to develop weapons of mass destruction so that they can kill millions of Americans?

And are we going to hide behind the idea that, oh, gee, there's nothing we can do. We were outvoted and there's just no replacement for these institutions. And if we hide behind that, can we at least go on the front page? Can the President of the United States at least explain to the American people that their money is gone to Baghdad, and especially that their money is going to Teheran, it is going to Damascus, and that when 10 years from now, God forbid, millions of Americans are killed by an Iranian or Iraqi nuclear weapon, and we hold hearings in this room, if it's still here, who financed the Iran or the Iraq nuclear bomb, and unfortunately, part of that may be us.

I'd like your comments. Are we going to continue to do business as usual?

Secretary O'NEILL. I must tell you I'm just staggered by that representation. It's simply not true.

Mr. SHERMAN. The IMF and the World Bank do not make loans?

Secretary O'NEILL. You said the American taxpayers, your constituents were sending money. That's just not true.

Mr. SHERMAN. No, my constituents, we have capital at risk.

Secretary O'NEILL. I'm sorry, Congressman. I tell you I care about these issues really deeply.

Mr. SHERMAN. As do I.

Secretary O'NEILL. And I care a lot about what we say to the American people out there about what we're doing. We have never, ever supported sending the American taxpayers' funds to Teheran, or to Damasacus.

Mr. SHERMAN. We have allowed our funds to be hijacked by others and sent there. It's our money mingled with European money that is going to Teheran right now.

Secretary O'NEILL. I'm sorry, that's not true.

Mr. SHERMAN. The money isn't being——

Chairman OXLEY. The gentleman's time has expired.

[The following information was subsequently furnished by Secretary O'Neill for the record.]

> Secretary O'Neill was correct in stating that Treasury has never "supported sending the American taxpayers' funds to Teheran, or to Damascus." It is true that the U.S. has not supported World Bank Group projects for Iran and Syria. The following offers greater detail.
>
> World Bank Group borrowing countries are divided into IBRD-only; therefore, they are ineligible to receive IDA assistance and receive none of the funds the Congress annually appropriates to IDA. To meet its lending requirement,

the World Bank uses paid-in capital from its shareholders to raise funds in the market. That borrowed money is lent to countries as "IBRD loans," which they repay with interest and an overhead charge.

The U.S. has opposed all World Bank Group projects for Iran or Syria, consistent with U.S. law and policy. IBRD lending to Iran resumed im May 2000 with the approval of two IBRD loans to Iran—a $145 million IBRD loan for the Teharan Sewerage Project and an $87 million IBRD loan for the Second Primary Health Care and Nutrition Project. The U.S. voted against these projects, but other shareholders voted in favor. There have been no loans to the Syrian Government. It should be noted that Syria has been in arrears to the World Bank since 1986.

Chairman OXLEY. The gentleman from California, Mr. Ose.

Mr. OSE. Thank you, Mr. Chairman.

First, Mr. Secretary, I want to thank you for coming. I know you're very busy. I appreciate your taking the time. I'm especially appreciative of the effort that the Administration is putting toward establishing partnerships both within and without the North American Development Bank, with our good friend, Mexico, to the south. The old real estate saying with which I'm familiar, is "you only want to own that which touches yours." Frankly, dealing with the problems in our backyard, are the height of leadership and I want to compliment you and your colleagues for doing that.

I want to go on to another question. We've had a lot of conversation today about the highly indebted poor countries. There are basically two classes of borrowers at the IMF. There's the HIPC countries and there's everybody else. I believe in a previous appearance here, you made a very clear that people who borrow money should repay it.

Secretary O'NEILL. Right.

Mr. OSE. Could you give us some sense of the borrowers, for instance the large borrowers not in the HIPC group, but everybody else and the status on their loans, please?

Secretary O'NEILL. Bill is reminding me there are almost no arrears in those that are not in the HIPC countries. You know, and I think to your point, we're making real progress on the idea that we should expect even very low income countries that they should be moving toward investment—grade sovereign debt. What that status would provide is a significant cushion against bad times in sovereign countries that have investment—grade debt. They would have in effect a balance sheet that lets them deal with unfortunate circumstance. We're moving in that direction. It's part of the reason we've been so forceful in saying we don't want to make loans to countries that are already saddled with debt that they can't pay because we're creating the next HIPC round.

Mr. OSE. I do think your point is very well made in the sense of creating a, if you will, a pit that you both throw money into forever. Let me go back to my first comment about the relationship with our good friend to the south. Could you give us some sense of the partnerships, both private and public, that are undertaken to date by the Administration with Mexico?

Secretary O'NEILL. I would say we're making wonderful progress. Both President Bush and Vincente Fox have worked hard at this relationship since the very beginning of the Administration. We had a conference about 10 days ago, chaired by Deputy Secretary Dam, and we're in the process now of pulling together a whole array of ways that we can strengthen the relationship between the U.S. and Mexico, and the economic integration between the U.S. and Mexico, to the benefit of both sides of the border. It's very interesting as we work this issue. Maybe one could argue that these should not be new discoveries, but to discover the amount of fees paid by people who are working on the U.S. side, and have relatives and family in Mexico that they're sending money back to. It's surprising to learn that often times they're paying 20 or 25 percent fees to financial intermediaries to move their money back and forth across the border. You know, it just cries out for a solution and we're in the process, I think, of making those connections that will make a huge difference in the value of funds earned in the U.S. and repatriated to families back in Mexico.

Mr. OSE. If I may make one observation on that particular point there have been discussions amongst us, particularly between me and the Chairman about trying to craft some statutory language that would facilitate the transfer of funds back and forth across the border between family members, and I look forward to interacting with you on that particular issue.

Thank you, Mr. Chairman.

Chairman OXLEY. Thank you and thank you for your leadership on this issue.

The gentlelady from California.

Ms. WATERS. Thank you very much, Mr. Chairman. I'd like to thank you for the time and I would like to thank Secretary Paul O'Neill for his willingness to testify before the Financial Services Committee today. I would also like to thank Chairman Bereuter for his comments on the International Fund for Agricultural Development and its contributions to HIPC.

To the Secretary. Unfortunately, the HIPC Initiative has failed to provide a lasting solution to the problem of poor country debts, because the IMF and the World Bank have refused to provide their fair share of debt relief. While the U.S. and the G7 countries agreed to cancel virtually all of the bilateral debts that poor counties owe them, the IMF and the World Bank are reducing these countries' debts by less than half. At least 18 of the 24 countries that have received debt relief are still spending more money on debt payments than they are on health care.

Zambia provides an excellent illustration of why deeper debt relief is necessary. Zambia is a deeply impoverished country with a per capita income of only $330. The infant mortality rate exceeds 1 percent of live births, and 27 percent of Zambian children under five are malnourished. Almost 10 percent of the population is infected with the AIDS virus and 650,000 children have been orphaned by AIDS. The HIV/AIDS epidemic has also ravaged the educational system by causing a shortage of trained teachers. Yet, Zambia's debt payments have actually increased following the receipt of debt relief. Moreover, Zambia still spends more than twice as much money on debt payments as it does on health care.

The President's budget includes a request for $850 million to replenish the International Development Association—IDA—through which the World Bank provides concessional loans to poor countries. The Financial Services Committee is expected to consider legislation this year to authorize a replenishment of IDA. IDA replenishment provides this Committee with an excellent opportunity to evaluate the progress of the HIPC Initiative and consider legislative language to provide deeper and more effective debt relief to impoverished countries.

Mr. Secretary, are you willing to consider expanding the HIPC Initiative to provide deeper debt relief? Do you think that the expected replenishment of IDA this year will provide an appropriate opportunity to consider additional debt relief legislation? How much debt relief do you believe the IMF and the World Bank should provide?

Secretary O'NEILL. Well, thank you for your questions. As you've indicated, and I think we had a little bit of a conversation last year about HIPC, there are still significant debt loads in many countries. That's part of the reason the President has said that we should not pile more loans on low—income countries, that we ought to move toward grant funding, especially for the lowest of low—income countries. And there's still much more to do. I think there's no doubt about that. One could think about expansion of HIPC as we see performance under the HIPC Initiative. Again, I think I said to you last year, one of the concerns I have about what we've done, or what the agencies have done, with HIPC is that they have presumed that having a forgiveness of certain kinds of loans, that countries are then in a financial condition that they can use the money that's theoretically freed up in interest payments and principle to go do other things of our determination. This is of great concern to me because it makes a presumption, I think, as you said in your own remarks, which is too often not true. The fact that certain debts have been forgiven doesn't mean that a country suddenly has a balance sheet that can support additional spending. It may not, in fact, be the right thing for the people of the country.

So one of the things that we've worked hard on is to try to get not just the Fund and the World Bank, but the so-called NGOs, the non-governmental agencies, to take a broader perspective on how we all think about what we're doing, so that in effect, we're not saying to the president of a country, do our bidding and we don't care what your other circumstances are. We've forgiven the part of the debt that you owed to us and therefore you must do our bidding for something else. I think this is a mistaken notion which we've been working hard to try to overcome.

But I think I agree with you, as I said earlier, that we should be building a case for more on the back of demonstrated performance that shows we know what we're doing, and we know what we're doing in a way that shows up in the average income levels of the people in these countries, not in some other measure that may be satisfying to us, but doesn't do any good in terms of the human living standards.

Ms. WATERS. Mr. Chairman, if I could get unanimous consent for 30 seconds?

Chairman OXLEY. Without objection.

Ms. WATERS. Thank you. Mr. Secretary, I would like to get back to the conversation that we had about technical assistance to some identified countries to have some demonstration of how we can help countries use some of their resources to deal with the problems of poverty. I just asked my staff if we had followed up. I think there's a letter in to you about that, and I'd like to get on the road in helping to make that initiative a possibility.

Secretary O'NEILL. I'd like very much to do that.

Ms. WATERS. Thank you.

[The prepared statement of Hon. Maxine Waters can be found on page 42 in the appendix.]

Chairman OXLEY. The gentlelady's time has expired.

The gentleman from Columbus, Ohio, Mr. Tiberi.

Mr. TIBERI. Thank you, thank you, Mr. Chairman. Mr. Secretary, with respect to Argentina, I have some constituents who are U.S. citizens who are natives of Argentina who work at Ohio State University, have expressed a dire concern about what's happening in South America and that they believe Argentina is a key to stabilizing the entire region. What's your view on that theory and how we should proceed to the IMF?

Secretary O'NEILL. Well, I must tell you I've spent a good deal of time with the people at the Treasury and the State Department, spent a good deal of time being engaged with Argentina. In the 13 months that I've been at the Treasury, Argentina represents a measurable fraction of what I've spent my time on, because we join you in believing Argentina is a very important country. It's been a great friend and ally of the United States for a long time. About 2 months before we arrived, the Clinton Administration before us, had worked with the IMF to agree to a program for Argentina that at the time I think was judged to be the largest ever including both what the IMF was doing and what private resources were doing. As I recall, the amount of money that was in the first program, the Clinton Administration program, was $43 billion.

In April all of that was gone, and we worked with the IMF and agreed a new program with Argentina that was some $20 billion. In August, that was all gone. And at the end of August, we agreed, quite reluctantly I might say, to one more round which encompassed $8 billion. And as you know, it didn't save the government of Argentina because they couldn't pay their bills.

It's not for want of trying on the part of the United States and the IMF that this failure has occurred. It was a long time in the making and there are difficult circumstances in Argentina which can only be fixed by the responsible officials in the Argentinian government. One of those problems is an ability on the part of the provinces, the equivalent of our States, to make binding obligations on the national government without the national governments having any say—so whether that's OK or not. As a consequence, the debt at the national level is so large that the revenue system only produces maybe 60 percent of the money that's required to pay the interest on the debt. This is a problem that can only be fixed in Argentina. We've had continuing conversations with President Duhalde and with the Finance Minister. I must say I am encouraged, that I think they are working in the right direction. Floating the peso was a good judgment.

Today's newspapers report that they think they've fashioned a solution to this provincial/national government issue. I haven't seen any details yet, but I'm hopeful because it is also clear that before more money shows up in the form of IMF assistance, the holes in the bottom of the bucket must be fixed.

Mr. TIBERI. Thank you, Mr. Secretary. Just to follow up, a number of Latin American countries are in a similar boat to Argentina. Ecuador is one that is trying to negotiate with IMF right now. Can you update us on that particular negotiation? And how does the proposed cut in the Andean Regional Initiative impact that negotiation?

Secretary O'NEILL. I'm happy to say—and as I do I knock on wood—that because of the way the Argentinian situation has been handled, that we've at least accomplished a pushback on the notion that existed in Washington a year ago or a year-and-a-half ago that we and the world were hostages to so-called contagion,— both economic and political contagion,— and that if there was a problem in one country, no matter if it was on the other side of the world, that it spelled doom for emerging countries and developing countries all over the world.

You know, I said at the beginning of this Administration I thought contagion was a man-made phenomenon and that it was possible for us to prove it wasn't necessarily so. We've worked hard to do that. And you know, I think as long as we are consistent—by we, I mean those of us in the developed world whose money is at risk or involved with IMF and the World Bank—as long as we are true to principles that we will help people with sustainable situations, and we won't bail people out who don't have sustainable situations, contagion doesn't need to exist in the world.

Chairman OXLEY. The gentleman's time has expired.

The Chair is pleased to recognize the gentleman from Iowa, Mr. Leach.

Mr. LEACH. Thank you, Mr. Chairman. And I know it's been a long day for the Secretary. Let me just make a couple of comments. One, your statement is unusual in the sense that you've talked about many subjects that weren't asked by the Committee and I think that's to be very much respected. You've gone beyond the Committee request.

Second, your leadership in terms of the grants issue is very impressive, and in terms of the European dissent from our position, based upon the lack of support the U.S. may have in the future for the international financial institutions, I will only say that obviously these institutions are always controversial. But I think Congress would be sympathetic to Treasury leadership, and that there is clear growing understanding in the United States, which will be reflected in Congress, of the need to balance the terrorism approach with the cause of terrorism remedies.

And one of the impressive aspects of the creation of the World Bank and the IMF was not that they were necessarily created after the War, which they were, but the design at Bretton Woods was during the War, 1944 and at the same time, the United States was enmeshed in War, it was attempting to deal with the issue of the causes of war as well as the causes of the Great Depression. And these are things that we can't skip. I would also say that I'm very appreciative that the Treasury has come down in favor of support of the World Bank AIDS Trust Fund, and I would only suggest that I think there would be more support in Congress for a higher funding level, and I hope you keep an open mind to that extent.

And the big picture is that we lost Americans on 9/11, but in Africa every two days more children die of AIDS than were killed in 9/11, and if there's an international world emergency, it has to be AIDS. And so I really think at this time, when we think of the international financial institutions, that has to be the forefront.

Finally let me say with regard to these that, as you know, George Soros has come forth with a program involving special drawing rights. It's fairly complicated. It may not have perfect support in lots of places, but I think it's the type of initiative that people ought to keep a little bit of an open mind and try to work with and see if there are modifications. At least it has some hope for producing more resources on an immediate timing basis. So I hope Treasury is not fixed in cement completely and totally on that issue.

Finally, because time is a little problem, I was really pleased in your opening statement that you mentioned the tax issue and international dimension of the tax issue. This Committee, as other committees of the Congress, have looked at aspects of Enron and to me, one of the obvious facts is that some of the legal aspects of Enron are in some ways deeper and more troubling than some of the illegal. And in particular, what appears to be a growing tendency of American corporations, not just Enron, to seek tax havens for that reason, to avoid taxation and to avoid American regulation.

The United States Treasury has historically been the bedrock institution that should lead concerns in this area. So I hope that the Treasury has task forces that are looking at this issue. I think Congress would be very sympathetic to initiatives that look at the tax have issue in as serious a way as possible. I don't know if you're prepared to comment on that. I hadn't intended to raise it, but you raised it in your testimony. Do you wish to comment on that?

Secretary O'NEILL. I'd be very happy to if you'd like.

Mr. LEACH. Please.

Secretary O'NEILL. Let me just say one quick word about George Soros and his idea about special drawing rights. I have a lot of respect for George Soros. He's someone I've known, and I've seen him quite a bit in the last couple of months. I have a lot of respect for George because he's spending $750 million a year of his own money, not somebody else's money, his own money, to work on these issues of economic development. So I have a lot of time for him and for his ideas. I must say, and I've said this directly to him, I'm concerned about the special drawing rights idea, because it's first of all complicated and I'm one who believes that as we work on these issues of economic development, we should do it in a way that's very transparent. If it's our intent to give more resources, I would like for us to appropriate the resources and say to the American people, we know what we're doing, and here's the evidence for what we're doing, and we're not using some clever devices to avoid direct engagement with the people, because I think this is so important it needs to be a direct conversation.

Now to the issue of so-called tax havens and tax structure. All the Members of this Committee are well-schooled in these things, and you know these two important things: that every aspect of the tax code was voted by the Congress and signed by some president. It's also true that there are characteristics of the tax code that a well-educated tax lawyer can look at and see, under a certain set of circumstances, that a company or a whole industry or many companies can reduce their legitimate tax bill by applying provisions that are in the tax code. There's no doubt about that, we all know that, and we call it tax avoidance.

There are other things that are done that people do that are illegal and they're called tax evasion. And in cases where people are doing tax evasion, I've got to tell you I am really dedicated to the proposition that the IRS and the law enforcement organizations of the United States pursue to the ends of the earth people who would cheat their fellow citizens by not paying their determined tax bill.

Having said those two things, I would say again what I say repeatedly. Our tax code is an abomination. It is just unbelievable how complex we have made these issues so that it's fairly difficult, I think even for the well-intentioned to figure out their tax bill. As I said the other night in a speech in Chicago, it's true there are five different definitions of a child in the U.S. tax code. You would think it would be easy to know whether or not, for taxpaying purposes, you have a child in your house. Not so easy. And the most complicated definition of a child is the definition having to do with the earned income tax credit, which means the lowest income people in our country are being asked to figure out the most complicated definition of what a child is when they apply for their entitlement to the earned income tax credit.

The Commissioner of Revenue has said to me, if he had to make this application, he would need assistance to do it, and I give you that individual—what I think is a real hole in the way we've got our tax code structured,— because I think people can connect to it. But the same kind of thing exists on the corporate side. Unbelievably complicated we made it, and I think we need to unmake it. In the next few weeks we at the Treasury are going to be presenting to Members of the Congress white papers on these subjects about what we can do for tax simplification to reduce the possibility that people will have the excuse that they didn't understand, so that the law can be clear and companies are very clear in what their tax obligation is to the rest of the American public.

Mr. LEACH. I appreciate that. My time has expired, but I hope that your statement is not implying that the issue of tax avoidance isn't serious, and the issue of American corporations going offshore to avoid American taxation isn't something the Treasury isn't going to be looking at, because I don't think you intended to, but when you make this distinction between evasion and avoidance, I hope you're not implying that the avoidance issue isn't serious too.

Secretary O'NEILL. I think it's a very serious issue and I think it's something we should look at together. What I was saying was that all of the opportunities for avoidance were enacted by the Congress and signed by a president. I'm not saying the Executive Branch doesn't have a hand in this. All of the opportunities for legal avoidance were enacted by Members of the Congress by a majority vote. I would be happy to work with you not only to eliminate the opportunities for avoidance but to make the tax code understandable.

Chairman OXLEY. The gentleman's time has expired.

The Chair would say I hope the Ways and Means Committee doesn't get a copy of this transcript.

[Laughter.]

Chairman OXLEY. We could have some problems.

Mr. Secretary, we appreciate your appearance again, your testimony and your insightful answers to a number of questions that obviously covered a wide range of issues. The Chair thanks you. The Chair notes that some Members may have additional questions which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for Members to submit written questions to the Secretary and to place his responses in the record, and it's so ordered.

Mr. BEREUTER. Mr. Chairman, I ask that my opening statement be made a part of the record.

Chairman OXLEY. Without objection, so ordered.

And again, Mr. Secretary, with our best wishes, thank you for being here. The hearing is now adjourned.

[Whereupon, at 2:55 p.m., the hearing was adjourned.]

APPENDIX

February 28, 2002

Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

February 28, 2002
The Honorable Paul O'Neill
Secretary, U.S. Treasury Department
Annual Testimony, International Financial System and International Monetary Fund

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Today, the Committee is meeting to hear from the Secretary of the Treasury, Mr. Paul H. O'Neill, on the state of the international financial system, IMF reform, and compliance with IMF agreements. This hearing is mandated by the fiscal year 1999 foreign operations appropriations bill, which provided for an $18 billion increase in U.S. funding of the International Monetary Fund (IMF). To ensure that the IMF would effectively use these funds, Congress included as a requirement, authored by Representative Castle, a senior member of our Committee, that the Treasury Department submit an annual report on the progress of IMF reforms and that the Treasury Secretary testify before this Committee on the state of the international financial system.

As I am sure you are aware Mr. Secretary, this Committee heard from Federal Reserve Board Chairman Alan Greenspan just yesterday about the conduct of monetary policy and the state of the domestic economy. Inasmuch as economic growth in the United States is necessarily intertwined with that of the remainder of the world, our Nation's economic growth is greatly impacted by disturbances and/or crises in the international economy, such as that currently occurring in Argentina. As a result this Committee welcomes this opportunity to both oversee U.S. international economic policy and at the same time looks very much forward to your insights into where that economic policy is heading.

At your appearance last year, you testified that reform of the international financial institutions was a key priority for the Administration and emphasized the need for the IMF and the World Bank to focus more narrowly on their core objectives.

You highlighted a number of issues, among them transparency, accountability, IMF crisis prevention, converting loans to grants, increased education in poor countries and the use of results based performance indicators. The Department's October 2001 report provides a helpful review to your testimony as well as an early insight into the success the Administration has had in pursuing Congressional directives codified in Section 1503 of the International Financial Institutions Act related to market-oriented reforms, trade liberalization, sound banking systems, work-out systems for sovereign debt and a host of other issues.

With a year as Secretary under your belt, the Committee looks particularly forward to your assessment of progress on these fronts.

In light of the almost daily news on Argentina's financial turmoil and the IMF's more than twenty year relationship with Argentina, I would expect that you will receive quite a number of questions about this long-term relationship and how Argentina could possibly find itself in the financial plight that it currently faces. Turkey is also a subject of interest, although perhaps less so than Argentina since it has not faced suspension of IMF assistance. There is also very strong interest in the Japanese economy. Although the Japanese are not recipients of IMF assistance, the IMF is conducting a Financial Sector Assessment Program in Japan and we would certainly welcome your thoughts on the prospects that Japan will finally address the long-term problem of non-performing loans in its banking system.

While I am personally not of the opinion that the IMF and World Bank have done their jobs in ways that call for radical changes in the manner in which they undertake their responsibilities, I do nevertheless feel that the Treasury Department's annual review, as it relates to IMF reform, is and will be of particular importance on a going forward basis and I look very much forward to receiving your views on this and other matters of import that you would like to discuss this morning, Mr. Secretary.

Let me just take a moment in closing to say how much I personally appreciate the strong leadership skills that you have frequently exhibited during your service at Treasury to date. Please also know that this Committee appreciates the good work that you and other members of your team have accomplished, such as reform of the Multilateral Development Banks and the International Monetary Fund, combating the financing of terrorism, the reconstruction of Afghanistan, attempts to raise the level of sustained global economic growth and lastly, ongoing efforts to strengthen the bilateral economic relationship between the United States and Russia. With all that being said Mr. Secretary, let me welcome you to your third appearance before our Committee.

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Opening Statement
House Financial Services Committee
Secretary O'Neill Testimony
The Honorable Doug Bereuter
February 28, 2002

Chairman Oxley and Ranking Member LaFalce, I would like to thank you for conducting this important hearing with testimony from the Secretary of the Treasury, Paul O'Neill. I would also like to welcome Secretary O'Neill to this hearing.

Focusing my remarks on the subject within the areas of responsibility of the Subcommittee I chair, I would note that that the Secretary of Treasury is required annually to come before this Committee and the Senate Committee on Foreign Relations to report on the condition of the international financial system and on progress in reforming these institutions. This requirement was enacted by Congress in 1998 as part of the FY1999 Omnibus Appropriations Act (P.L. No. 105-277) which provided for an $18 billion increase in the U.S. quota for the IMF.

Of course, the United States was the leading founder and continues to be the largest contributor to both the World Bank and the IMF. In addition, the U.S. is an active member of the regional multilateral development banks and the Secretary of Treasury and his representatives are responsible for implementing U.S. policy towards these institutions.

Today, I would like to particularly emphasize two items: last year's activities of the Subcommittee on International Monetary Policy and Trade which addressed international financial institutions; and possible activities of this Subcommittee regarding these issues in the coming year.

Relevant activities of the Subcommittee on International Monetary Policy and Trade in 2001

Last year, the Subcommittee focused on the regional multilateral development institutions. In fact, H.R. 2604, which I introduced with bipartisan support, authorized the United States' participation in the Asian Development Fund and the International Fund for Agriculture Development and provided additional policies for the United States also towards the African Development Bank, the African Development Fund, the Asian Development Bank, the Inter-American Development Bank, and the European Bank for Reconstruction and Development. This legislation, H.R. 2604, particularly addressed the subjects of HIV/AIDS, user fees, and transparency.

Subsequently, the House Financial Services Committee passed H.R. 2604 by a voice vote on October 31, 2001. However, we are still waiting for the House Floor to take up this legislation. It is important to note that IFAD was authorized in the FY2002 Foreign Operations bill which was signed into law. However, the Asian Development Fund still needs to be authorized. As a result, I believe it is very important that the full House Floor debate this legislation in the immediate future.

For tactical reasons, we have linked the House Floor consideration of the regional development institution legislation, H.R. 2604, with the Export-Import Bank Reauthorization Act of 2001 which also passed the Financial Services Committee on October 31, 2001, by a voice vote. Mr. Secretary, I am concerned that we have no resolution on Treasury's role in the approval of Ex-Im Bank's Tied Aid War Chest transactions. The actions early last year on the Ex-Im Tied Aid War Chest by representatives of the Department of the Treasury were arbitrary, inappropriate and excessive. In addition, the Treasury Department did not follow its own standards on follow-on sales.

On January 28, 2002, I was finally able to gather representatives of the Treasury Department, the Ex-Im Bank, and the White House on the Tied Aid War Chest. At this meeting, we asked for the language in our Ex-Im bill to be accepted on the Tied Aid War Chest or for proposals for reasonable and minimal changes to be suggested by the Treasury Department and the Export-Import Bank. We have asked for White House involvement to bring resolution to this situation.

Weeks have passed and we have received no response. In addition, I sent a letter to you, Mr. Secretary, dated February 15th, and to my knowledge I have not yet received a response. The expiration of the authorization of the Export-Import Bank is on March 31, 2002. This authorization has already been extended from its original September 30, 2001 expiration date. Treasury should understand that since Treasury officials have been, with or without authorization, threatening vetoes of this legislation, its incumbent on them to be cooperative and expedite any kind of negotiated conclusion. Now, it maybe much more difficult to pass an Ex-Im reauthorization than it was one or two months. It is intransigence at Treasury that is responsible for the delay. We cannot responsibly pass a so-called clean authorization as every administration requests; reforms are clearly needed and we will resist an end-around this Committee through the Appropriations Committee.

Furthermore, in 2001, the Subcommittee on International Monetary Policy and Trade conducted hearings on the subject of Africa. The Subcommittee's first hearing was on the African Development Bank and Fund, which has had the most fiscal and management difficulties of all the multilateral development banks. In addition, my Subcommittee also conducted a hearing on World Bank and IMF activities in Africa last year.

With respect to 2002, the Subcommittee has already begun its examination of the Argentine financial crisis. On February 6th, the Subcommittee conducted a hearing with Undersecretary John Taylor of the Treasury Department testifying on the subject of Argentina. Moreover, on March 5th, the Subcommittee will hear from a distinguished panel of witnesses on the subject of Argentina including, among others, Dr. Alan Meltzer, who was the Chairman of the Meltzer Commission, and Dr. Fred Bergsten, who wrote a strong dissenting view to this Commission's majority report. I take a particular interest in the work of this Meltzer

Commission since I authored the language establishing the Commission, which was included in the FY1999 Omnibus Appropriations Act. This 11-person bipartisan Commission, which became known as the Meltzer Commission, was charged with performing a fundamental re-examination and review of the IMF, the World Bank, and other international financial institutions.

At our recent hearing, Undersecretary Taylor supported a concept that certain pre-qualification criteria should be required before a country can receive IMF assistance. The Meltzer Commission had this same recommendation. I am interested in any further perspective that the Secretary might give on this subject.

Additionally, the Committee expects very important authorization requests this year from the Administration for U.S. contributions to the International Development Association (IDA), the African Development Fund, and the Global Environmental Facility (GEF). I am aware that there is doubt about whether GEF needs to be authorized in legislation. The total multi-year replenishment for these institutions is as follows: $2.85 billion for IDA-13, $354 million for the African Development Fund, and $430 million for the Global Environmental Facility. You need this Committee's cooperation and assistance on these authorization requests and we need you.

With respect to IDA, which is the concessional part of the World Bank, I am aware that the Administration has proposed converting up to 50% of loans for poor countries into grants. One of the Meltzer Commission recommendations was also to convert loans into grants. I have not yet formulated a final personal conclusion on this subject and I am awaiting a GAO study on this matter, which I co-requested with Senator Jessie Helms (R-NC), the Ranking Member of the Senate Foreign Relations Committee.

Moreover, with regard to IDA, I am interested in the thoughts of the Secretary as it relates to the Administration's proposal to give additional contributions to IDA for a country successfully utilizing IDA funding to deliver measurable results in a country in areas such as education, health, or environment.

Furthermore, the African Development Fund also needs to be authorized this year. As I mentioned earlier, the Subcommittee conducted a hearing on this subject last year. With respect to the Global Environmental Facility, which also needs to be authorized this year, the World Bank serves as the trustee of this fund which pledges money to protect the global environment.

In conclusion, I look forward to the testimony of Secretary O'Neill on the subjects that I mentioned, and on other areas relevant to the international financial architecture. Thank you.

Statement of the Honorable John J. LaFalce
Hearing on the State of the International Financial System
Committee on Financial Services, U.S. House of Representatives
February 28, 2002

Mr. Secretary, welcome. You appear before us at a very important time for the global economy and for U.S. policies as they relate to the global economy. I want to highlight two areas today: the on-going negotiations to replenish the World Bank's International Development Association (the so-called "IDA"), and the discussions related to the creation of a mechanism for handling debt crises, particular in the aftermath of the Argentine debt default.

First, I want to offer my strong support for your efforts to shift more of IDA assistance toward grants. The grants initiative is a natural extension of our debt relief efforts, which are already bearing fruit in the heavily-indebted poor countries, freeing up budgetary resources in those countries to devote to critical social spending. Yet, each year that we continue to provide 99% of IDA assistance in the form of loans, particularly for non-economic expenditures such as AIDS relief, nutrition, and education, we are chipping away at the benefits that debt relief has provided to these countries. In effect, we are forgiving debt with one hand only to pile on new debt with the other – this is clearly not a viable long-term development strategy. Frankly, few of the objections that critics raise to the grants proposal ring true to me – in particular, that a shift to grants inappropriately moves the World Bank onto the United Nation's turf as the international grant-making institution. Such arguments smack of defending the status quo at the expensive of doing what is best for the world's poor.

That said, I think that the intransigence of the Europeans on this issue may reflect some other problems with the U.S. position when it comes to funding for the IDA and for Official Development Assistance in general. As David Beckman of Bread for the World has said, these critics are suspicious of the grants proposal because they have long perceived the U.S. to be very stingy when it comes to development assistance. Now, you have attempted to counter that perception by offering increases in the IDA contribution over the next three years, starting at $850 million in 2003 and increasing to just over $1 billion by 2005. But the increases are conditioned on performance targets.

And here is where I take some issue with you. I strongly believe that the U.S. should commit, at a minimum, to the upper range of the funding levels you have proposed, independent of artificial performance targets. As you know, Nobel economist Joe Stiglitz has said that even if the U.S. doubled its IDA contribution, we could be confident that the money would be well-spent. His point is that the World Bank has already come a very long way in evaluating successes and failures and in using that information to improve development assistance. As a result, any number of viable development projects currently go unfunded for lack of adequate donor support.

Of course we should look to benchmarks for progress as we allocate funds to all of the MDB's. But I am concerned that the performance targets initiatives will encompass areas that are inherently difficult to measure and do not lend themselves to use as annual benchmarks. For example, you've rejected school enrollment as an appropriate metric in favor of outcome-oriented measures such as ability to read and write. Of course I share the desire to focus on outcomes, but one only needs to consider the painfully slow process of seeking education performance measures in this country to recognize the practical problems with doing the same in the world's poorest countries.

Rather than a finely-tuned matrix of empirical measures, I fear that what we will really get is a highly subjective judgment from Treasury officials about whether a target has been met or not, something akin to the OMB scorecard for agency performance that was unveiled in this year's budget. And with Mitch Daniels desperate to find cost savings around every corner, there will be tremendous pressure to keep U.S. funding for IDA as close to the baseline as possible. So while I do not reject the use of benchmarks or performance targets entirely, I believe their success hinges on the details and I am eager to hear more from you on these details.

Let me briefly move to the so-called international bankruptcy regime. I have been a long-time advocate for the creation of a debt-workout mechanism. The devastating economic crisis in Argentina amply demonstrates the need for such a mechanism. Indeed, I think the crisis Argentina has provided momentum to discussions within the IMF and in Treasury over the nature of a regime for addressing debt crises. Based on Mr. Taylor's recent comments, it appears that the Treasury has parted ways with the IMF on how best to structure a proposal. Nonetheless, I am eager to the move the discussion beyond the academic and toward a concrete plan, and I hope we can do so through legislation as quickly as possible.

Hearing on International Financial Institutions
Committee on Financial Services
Statement by Rep. Maxine Waters
February 28, 2002

I would like to thank Chairman Michael Oxley for organizing this hearing on the state of the international financial system and the International Monetary Fund (IMF). I am also grateful to the Honorable Paul O'Neill, the Secretary of the Treasury, for his willingness to testify before the Financial Services Committee today.

I appreciate Secretary O'Neill's support for full funding for the Enhanced Heavily Indebted Poor Countries (HIPC) Initiative in fiscal year 2002. However, I am disappointed that the Administration did not request any funding for the HIPC Initiative in fiscal year 2003. Congress must provide $135 million in additional appropriations in fiscal year 2003 in order to fulfill the U.S. commitment to the HIPC Initiative. I hope the Secretary will explain why these funds were not included in the budget.

The purpose of the HIPC Initiative was to free impoverished countries from the burden of debts and allow them to invest their resources in HIV/AIDS treatment and prevention, health care, education and poverty reduction programs. The HIPC Initiative has already yielded positive results. Tanzania has eliminated school fees, and Honduras is now providing a free education to all children through the ninth grade. Mozambique is vaccinating one-half million children against childhood diseases, and Uganda has doubled school enrollment and significantly reduced the rate of HIV transmission.

Unfortunately, the HIPC Initiative has failed to provide a lasting solution to the problem of poor country debts, because the IMF and the World Bank have refused to provide their fair share of debt relief. While the United States and the G-7 countries agreed to cancel virtually all of the bilateral debts that poor countries owe them, the IMF and the World Bank are reducing these countries' debts by less than half. At least 18 of the 24 countries that have received debt relief are still spending more money on debt payments than they are on health care.

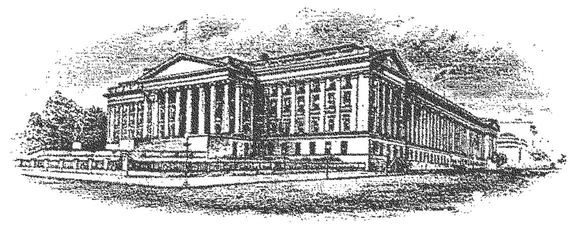
Zambia provides an excellent illustration of why deeper debt relief is necessary. Zambia is a deeply impoverished country with a per capita income of only $330. The infant mortality rate exceeds one percent of live births, and 27 percent of Zambian children under five are malnourished. Almost 10 percent of the population is infected with the AIDS virus, and 650,000 children have been orphaned by AIDS. The HIV/AIDS epidemic has also ravaged the educational system by causing a shortage of trained teachers. Yet Zambia's debt payments were actually *increased* following the receipt of debt relief. Moreover, Zambia still spends more than twice as much money on debt payments as it does on health care.

Last year, I introduced ***H.R. 1642, The Debt Cancellation for the New Millennium Act.*** This bill would require the IMF and the World Bank to provide complete cancellation of 100% of the debts owed to them by all thirty-two impoverished countries that are expected to qualify for the HIPC Initiative. The bill would also allow three additional impoverished countries -- Bangladesh, Haiti and Nigeria -- to participate in the HIPC Initiative. Seventy-eight Members of Congress representing both political parties have cosponsored this bill.

I hope that the Financial Services Committee will consider legislation this year to expand the HIPC Initiative and provide complete debt cancellation to impoverished countries. It is time for the IMF and the World Bank to cancel these countries' debts once and for all.

I look forward to hearing the testimony of Secretary O'Neill at today's hearing, and I hope he will share his views regarding the progress of the HIPC Initiative and the need for deeper debt relief.

I thank the Chairman for the time.



DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

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U.S. LEADERSHIP IN THE GLOBAL ECONOMY

**TESTIMONY OF TREASURY SECRETARY PAUL H. O'NEILL
BEFORE THE COMMITTEE ON FINANCIAL SERVICES
OF THE HOUSE OF REPRESENTATIVES
FEBRUARY 28, 2002, 1:00 P.M.**

I. Introduction

Chairman Oxley, Representative LaFalce and Members of the Committee, thank you for inviting me here today to discuss President Bush's international economic agenda and our efforts at the Treasury Department to advance that agenda.

Mr. Chairman, when I accepted the job of Secretary of the Treasury, President Bush directed me to meet a number of important challenges. One of those challenges – one I take very seriously and personally – is our nation's role in international economic growth and development. The President's message to me was very clear: if we care, and we have simple respect for human dignity, then we must finally begin to deliver on a half-century of unfulfilled promises to raise the standard of living of poor people living – and dying – in the world today. President Bush feels that U.S. leadership is essential to meet this challenge and I agree with him. The United States should be a locomotive of global economic growth and a champion of economic development in those parts of the world that have lagged behind.

Let me be clear: the creation of economic growth and jobs in the U.S. economy is our overriding concern. In fact, I believe that getting our economic policies right at home is one of the best contributions we can make to global economic growth.

It is also true that growth and prosperity in the global economy are vital interests of the United States because economic growth is associated with peace, stability, democracy, innovation, and the expansion of markets. These are important national goals. An even more fundamental goal for our nation is to see that the people of the world have the opportunity to live at their potential. That is a hope each and every one of us holds out for the world, and we have an obligation to do what we can to achieve it.

When the leaders of the free world joined together more than fifty years ago with a commitment to speed the progress of the underdeveloped world, they could not have imagined how slow progress would be. This is especially unsettling since over those same fifty years, we have also witnessed incredible feats of human progress. Countries have risen from the ashes of war to become vibrant, thriving members of the community of nations. People have struggled and succeeded in discarding the yoke of totalitarian regimes to create free democracies. Today, more people than ever before in the history of the world have the opportunity to compete, to reap the benefits of their labor and creativity in free markets, and to create wealth. And the resultant miracles of science, health, and technology are truly inspiring.

So why are so many people still poor? Why have so many people been left behind?

It is not because the people in developing countries aren't capable of all the same advances the rest of the world has created. In my experience running a global enterprise, I saw brilliant ideas put forward by people in every corner of the world. What is lacking in the nations that have failed to progress is a system that supports the deployment of new ideas. Most of the basic building blocks of such a system are relatively inexpensive: good government, good educational systems, the rule of law, respect for property rights, a commitment to free markets, a commitment to peaceful relations with neighboring countries.

But for many countries these foundations for development are beyond their reach – either for lack of money, lack of know-how, or lack of encouragement or incentives to do the right thing. And in some cases, countries have simply been led down the wrong road because of policy prescriptions from the international community and the sometimes perverse incentives our international assistance programs have created.

I believe that we can succeed in effecting change. Let me take a few minutes to discuss some of the ways we are trying to drive change.

II. Strengthening International Economic Cooperation

Achieving economic growth and stability is absolutely fundamental to improving the lives of our citizens and those all around the world. And it is vital to greater security for all of us. With this in mind, we spend an enormous amount of time and effort working with other countries toward these goals.

One of the challenges we face in this task is balancing the need to provide leadership and impetus with the importance of respect and deference to other countries' decision-making processes. As President Bush has said, the United States should not lecture other countries but rather should respect their sovereignty concerning their own policies. Indeed, a fundamental principle of our approach is that other countries should have ownership of their economic policies. Governments need to bear the responsibility for addressing their own economic problems and challenges – and ensuring that they choose prudent policies that will bring them sustained growth and stability over the medium and long term. We would accomplish little if we tried to force them to follow our wishes, since only lasting and committed implementation of economic policy measures will deliver real results.

This is why, while seeking to deepen and enrich our contacts and cooperation with other countries on economic and financial issues, we avoid pressuring countries to adopt our solutions to their problems. The ongoing dialogue that we maintain with our Group of Seven (G-7) partners has embodied this approach. We value our interactions with our G-7 colleagues. At the same time, we are careful in these sessions to be sensitive to the fact that each country needs to – and should be encouraged to – pursue policies appropriate for its own circumstances.

G-7 meetings provide key opportunities to share information, discuss policy considerations in our own economies and pursue innovative approaches to international policy issues of shared concern. In recent months, we have had concrete discussions with others in the G-7 on how to achieve our common objective of higher global economic growth. We expect to issue a quantitative, fact-based study around the time of the G-8 Heads of State Summit in June that discusses a number of policy changes that could vastly improve global economic growth. The G-7 is also working together on a variety of other issues, including our efforts to rid the world's financial system from terrorist fundraising activities and reform of the international financial institutions.

III. Enhancing Stability and Growth: Reform of the International Monetary Fund

To unleash human economic potential, it is vital that economies have a sound and stable basis on which to grow. Cultivating conditions in the international economic and financial system that support growth is the job of the International Monetary Fund. Indeed, rather than serving as a firefighter for crises, the IMF should become more like a gardener, nurturing the seeds of private sector growth.

The first task is to prevent the eruption of crises that undermine and reverse growth. This is a formidable intellectual challenge, since it is difficult at best to identify trouble far enough ahead so that something can be done to prevent it. And it is equally a leadership challenge, since prevention requires the political will to take decisive and often unpopular steps early in order to avert a crisis that may not yet be apparent to others. Enhancing its crisis prevention role means that the IMF must take a number of steps. It needs to do better in detecting signs of trouble itself, and with our encouragement the IMF is taking steps to strengthen its internal early warning systems. Greater transparency is also fundamental, both on the part of the IMF and its member countries, so that financial markets can discern the true performance and potential risks of individual economies and the system as a whole. When countries publish timely data on their performance, markets can make informed decisions – and this is indeed happening now, with forty-nine countries complying with the new standards for data disclosure. For its part, in addition to being more transparent about its operations, the IMF needs to speak out when it sees trouble looming. It is up to countries themselves to make policy changes to avoid crises, but the IMF must make itself more vocal in identifying problems as they develop.

I want to touch briefly here on contagion. I was criticized last year when I said that contagion was not something that God intended us to have. But I saw that something important was changing in international financial markets, and I thought that it was important to draw attention to it to further drive that change. Fear of contagion can cause the IMF and others to do things that shield investors from the risks of their investments, which only increases the chances that a crisis will recur. In fact, financial markets, aided by greater access to information, are now increasingly differentiating between those countries that are pursuing strong, growth-oriented policies and those that are not. This is an important development.

To be more effective in cultivating growth, the IMF also needs to narrow the focus of its involvement in member economies. In the past, the IMF allowed its activities to expand into areas outside those central to its mission and thus to overlap with the mandates of the multilateral development banks, for instance in promoting agricultural reform and judicial reform. The IMF does not have a comparative advantage in addressing such issues, and attempting to do so arguably diminishes the Fund's effectiveness in pursuing more central objectives. Rather, the Fund should focus on monetary, fiscal, exchange rate and financial sector policies that lay the macroeconomic framework for growth.

The IMF is already making progress in narrowing the focus of its work. New country programs reflect a sharper concentration on key areas and a prioritization of measures necessary for reforms to succeed. This is a welcome change. And a broader review of the conditions attached to IMF lending continues. As part of this review, we are emphasizing the need for the IMF to be selective in providing financial support. The IMF needs, in short, to demonstrate a greater willingness to focus its support on countries doing the most to help themselves, and to decline to finance cases in which a country is not prepared to take the steps required to achieve credible reforms and a sustainable growth path.

One important mechanism for identifying and supporting countries that are truly committed to reform is to make greater use of "prior actions." These are conditions that countries must meet before a program is approved and Fund resources are disbursed. As such, they provide the opportunity for countries to demonstrate their strong commitment and ownership of sound economic policies – and for the IMF to ensure up front that reforms will be implemented. This approach was important to the IMF's support for Turkey in May last year, when Turkey took decisive steps to implement nine key prior actions before the IMF agreed to a new program with increased financing.

But this in itself is not enough to change fundamentally the role of the IMF in the international system. Rather, we need to make clear that there are limits on official support to countries in unsustainable situations – that they will not be "bailed out" despite a history of bad policy choices and a lack of commitment to reform. This is essential to avoid distorting incentives for countries and investors alike. It is up to the IMF and its members to impose such limits. This does not mean that we should set rigid ceilings on the amount of financing that the IMF can provide when a country is adopting a strong reform program. But it does mean reining in the tendency to provide generous financing packages when a country's debt situation is unsustainable and tough-minded reforms are needed.

This brings me to a particularly difficult but critical issue – what to do when a country's debt situation is unsustainable. Despite several recent incidents, there remains no clear, agreed approach to dealing with such a situation. And the uncertainty that remains simply creates too much pressure for large-scale official lending by the IMF and may contribute to decreased investor willingness to invest in some emerging markets.

To help reduce this uncertainty, we are working with others in the official sector in considering the development of a sovereign debt restructuring mechanism that will provide a more predictable framework for debt workouts. Having such a workout strategy in place may help reduce the pressure for large-scale financing – and it may also create the potential for increased capital flows to emerging markets at lower interest rates. Of course, creating and implementing such a mechanism are not simple tasks. A number of options for the design and implementation of this mechanism are being considered. For our part, the U.S. Treasury is emphasizing the need for a mechanism that is market-based, encourages creditor and debtor ownership of the process, and avoids raising concerns about conflict of interest. One option that fulfills these criteria would encourage borrowers to put certain clauses in their debt documents to help facilitate a more orderly process if a restructuring is necessary. Of course, there are many issues that would need to be considered in implementing such an approach, including how to encourage the use of these clauses in debt contracts. As we proceed, we are consulting with various experts in the private sector, and we look forward to continuing to consult with the Congress as well.

IV. Building Key Bilateral Economic Relationships

Let me spend a few minutes discussing some of our key initiatives in the bilateral area, where we have made a major effort to focus our economic relationships on concrete, measurable goals, with specific timelines for achievement.

Economic Component of the Strategic Framework with Russia

First, Russia. During our meeting with President Putin last summer, Commerce Secretary Evans and I agreed to develop a checklist – a time-bound list of concrete accomplishments that both countries want to achieve in the economic sphere – that would allow the United States and Russia to measure progress on our bilateral economic agenda. In the ensuing months, we worked with President Putin's economic team to develop a list that includes specific steps to advance Russia's WTO accession, to help Russia build a business climate to attract private investment, and to further our common goal of fighting money laundering and terrorist finance. Two important items on this checklist relate to the creation of a sound Russian banking system – capital needs to be much more broadly available in Russia to those outside the natural resource-based sectors. First, we have helped launch a U.S.-Russia Banking Dialogue as a vehicle for practical private sector ideas. And, second, we support expanding the EBRD's Russia Small Business Fund which has been extremely successful in giving small businesses all over Russia access to credit on market terms.

Additionally, it is important to give credit for strong policy reform where credit is due. Following the August 1998 financial crisis, Russia floated its currency and undertook comprehensive tax reform, including the establishment of a flat 13 percent personal income tax and a dramatic overhaul of its tax administration system. Growth has rebounded strongly, averaging over 6 percent a year in 1999-2001. And because of these policy actions, what was a fiscal deficit of 6 percent of GDP in 1998 became a fiscal surplus of 2.5 percent of GDP in 2000. The reduction in the corporate income tax from 35 percent to 24 percent, which went into effect in January 2002, will help support this trend.

U.S.-Mexico Partnership for Prosperity

Second, Mexico. President Bush has said, "The stronger Mexico is, the less pressure on our border; the stronger Mexico is, the more prosperity there will be in both our countries." And, "Trade with Mexico is an integral part of making sure that our hemisphere is safe, secure and prosperous." Mexico and the United States share more than just a geographical border. Since signing the North American Free Trade Agreement in 1993, Mexico has become the U.S.'s second largest trading partner and fastest growing export market. Our business cycles are closely aligned, and financial markets increasingly view Mexico's economy as more closely linked to the U.S. than to Mexico's Latin American neighbors.

These growing links and the close relationship between President George W. Bush and Mexican President Vicente Fox prompted the leaders to form the U.S.-Mexico Partnership for Prosperity in September 2001. The goal of the Partnership is (i) to unleash the economic potential of every citizen, (ii) to harness the power of open markets and private enterprise in order to spur economic development in Mexico, and (iii) to do so through an authentic Partnership not just between governments, but also between our respective private sectors.

Official flows from the U.S. and the international financial institutions are dwarfed by private flows to Mexico. The Partnership is dedicated to facilitating those private flows, maximizing them, and leveraging them through coordination with other private flows and official flows. Along with top government officials from the U.S. and Mexico, experts from business and academia have come together in a series of roundtable discussions to develop ideas to stimulate investment and growth in Mexico and achieve the goals of the Partnership.

A final report is being drafted jointly with public and private sector participants from both Mexico and the U.S. and will be presented to President Bush and President Fox on March 22 at the UN Financing for Development Conference in Monterrey, Mexico.

Reconstuction of Afghanistan

Finally, Afghanistan. The international donor community is committed to close coordination on reconstruction efforts for Afghanistan. Treasury, working closely with the State Department, initiated efforts to begin the multi-year, multi-billion-dollar process of Afghanistan's reconstruction. On November 20th 2001 – even before the formation of the Afghan Interim Authority – senior officials of the international donor community came together in Washington, D.C., to begin discussing a structure and process for Afghan reconstruction assistance. An early accomplishment was the formation of the Afghanistan Reconstruction Steering Group (ARSG), co-chaired by the United States, Japan, EU/EC, and Saudi Arabia. This group's role is to provide political impetus, encourage contributions and provide overall policy guidance to the international economic reconstruction effort. The first ARSG meeting was held in Brussels on December 20-21, 2001.

Since November, the United States has been a leader in catalyzing international donor efforts. Secretary Powell and I led the U.S. delegation to a January 2002 Tokyo meeting of the Steering Group, where donors pledged some $1.8 billion for Afghan reconstruction efforts in 2002, and a preliminary initial total of $4.8 billion for the 2002 - 2006 period. Ministers and representatives from 61 countries and 21 international organizations attended. The Conference demonstrated the strong commitment of the international community to reconstruction assistance to Afghanistan by making specific commitments and pledges. Afghan and international NGOs held a separate meeting. Experts also met to discuss military demobilization, military and police training, counter-narcotics issues and alternative development.

IV. Raising Economic Growth and Reducing Poverty: Reform of the Multilateral Development Banks

President Bush has said: "A world where some live in comfort and plenty, while half of the human race lives on less than $2 a day is neither just, nor stable." Poverty today remains widespread and deep. About 10 million children die each year, most from preventable diseases. More than 113 million primary school age children do not attend school, with forty percent of the children in Sub-Saharan Africa out of school. Approximately 1.3 billion people lack access to adequate quantities of clean water and nearly 3 billion people are without adequate sanitation, leaving them vulnerable to disease. The HIV/AIDS epidemic continues to spread relentlessly, with over 12 million orphans aged 14 or less in Africa alone, and is rapidly reversing the hard-won development achievements of many countries. The magnitude and human consequences of the development challenge we now confront underscore the need for international development assistance efforts to do a much better job than they have been doing in increasing opportunities for people to create a decent living for themselves and their families. We can and must do better.

In my travels around the world, I have seen an untapped reservoir of human potential in all countries, including the poorest. To fully realize this potential, countries need to create an environment with the institutional conditions and incentives – including the rule of law, enforceable contracts, stable and transparent government, and a serious commitment to eliminate corruption – required to encourage individual enterprise and to provide individuals with the health, knowledge, and skills they need to participate in and contribute to economic activity. Donors and external assistance can help only if the right fundamentals (including policy environment and institutions) are in place to harness human potential. For this reason, we have worked hard with other shareholders in the multilateral development banks (MDBs) to concentrate assistance on those countries with sound economic policies and good governance practices. For example, for the IDA-13 replenishment period, 17 countries will have their IDA lending allocations significantly reduced due to poor governance ratings.

Rising productivity is the driving force behind increases in economic growth and rising per capita income. We have been pressing the MDBs to focus more intently on operations that raise productivity growth, concentrating on such operations as:

- Improving education and health;
- Promoting private enterprise, including small and medium enterprises;
- Promoting rule of law, effective public expenditure management, accountability and anti-corruption; and
- Opening economies and strengthening trade capacities and investment environments.

Mexico's homegrown PROGRESA program provides a good example of a productivity enhancing investment in children's human capital that should have enormous future dividends. The program, initiated in 1996 and supported by the MDBs, provides financial transfers to the rural poor conditional on keeping children in school and providing them with basic preventive health care and nutrition. Education grants are supporting schooling for 3.6 million poor children, and nutrition and health grants are benefiting 1.6 million children aged 0-5 years of age. It is estimated that children's educational achievement has increased by about 10 percent in the first three years of the program.

As a result of U.S. efforts, productivity is receiving more emphasis in the debate on MDB policies within the institutions and among other shareholders. We will continue working actively to ensure it becomes a hallmark of actual operations. Our goal is to raise economic growth, improve living standards, and improve economic stability in the world economy.

The scale of global poverty and unrealized human potential underscores the importance of the MDBs (and all other donors) focusing much greater attention on improving the effectiveness of their assistance. We are pressing all the MDBs to establish monitoring and evaluation systems that measure development results. In IDA-13, the U.S. is providing supplementary funding conditioned on measurable results in areas crucial to economic growth and poverty reduction. In response to a request I made of World Bank President Jim Wolfensohn in Ottawa last November, the World Bank is undertaking a study of development effectiveness and the "lessons learned" from operational successes and failures. This study will feature prominently in discussions at the upcoming Financing for Development Conference in Mexico and the G-8 Summit in Canada. Our challenge, going forward, will be to ensure that the successes and failures of the past fifty years guide and improve development efforts in the future.

Private sector development is crucial to economic growth and poverty reduction. We believe that the MDBs can play a larger role in promoting needed investment climate reform and in channeling technical assistance and project finance to fund viable private sector projects in countries that are committed to implementing policy and regulatory changes to ensure a sound investment climate.

President Bush has also proposed that up to 50 percent of the World Bank and other MDB funds for the poorest countries be provided as grants rather than as loans. This is an important part of the Administration's MDB growth agenda. Why? Because grants are the best way to help poor countries make productive investments without saddling them with ever-larger debt burdens. Investments in crucial social sectors (e.g., health, education, water supply and sanitation) do not directly or sufficiently generate the revenue needed to service new debt.

Take, for example, IDA's effort to address the HIV/AIDS pandemic in Africa. The Multi-country AIDS Program (MAP2) is a framework arrangement providing for a series of independent IDA credits/grants with a total value of $500 million to be committed over the next three years in Africa. Unfortunately, IDA's proposal for MAP2 would allow for only a maximum of 20 percent (or up to $100 million) of total financing to be provided in the form of grants instead of loans. I believe such assistance should be delivered on entirely grant terms. How can we expect countries to take on additional debt to fight the scourge of HIV/AIDS? There are no revenue streams directly associated with controlling the spread of HIV/AIDS or treating its victims. Development assistance on grant terms in such cases is the only viable alternative.

This project also demonstrates the important role the World Bank has to play on critical development issues. That is why we have supported and will continue to support the World Bank as well as the other MDBs. President Bush's budget calls for an 18 percent increase in the U.S. contribution to IDA linked to improvements in IDA's performance. He has also called for an 18 percent increase in the U.S. contribution to the African Development Fund.

Unfortunately, the U.S. proposal on grants has been opposed strongly by other donors participating in the IDA-13 and African Development Fund replenishments. It is important to reach an agreement on grants that will facilitate closure on these important replenishments. The United States has demonstrated flexibility on this issue. Final agreement will depend on other donors also demonstrating commensurate flexibility.

The Administration's FY 2003 budget request of $1,447 million for Treasury's international programs reflects our development priorities. Economic progress in the developing world is enormously important to the United States. The need to reduce extreme poverty and improve the lives of people around the world is a priority in and of itself. Because poverty and economic instability can be a breeding ground for terrorism, our fight against terrorism makes our collaborative efforts with our partners to improve the lives of the world's poor take on a new and more strategic dimension.

The Administration's request provides for:

- $1,259.4 million to fully fund annual U.S. commitments to the MDBs;
- $177.7 million to fund the first year of a three-year plan to clear U.S. arrears to the MDBs; and
- $10 million for technical assistance to finance expert advisors to countries facing economic transition or security issues and for training governments' finance ministries and offices to combat terrorist financing.

This request will enable the MDBs to address critical development issues in key regions. It projects U.S. leadership, and it complements our reform efforts to strengthen the effectiveness of these institutions.

V. Promoting Global Free Trade

The global economic slowdown also brings into sharp focus the reasons why we need increased trade. The drop in U.S. trade (both exports and imports) coincided with a deceleration of U.S. growth during 2001. Trade is important to the U.S. economy, and freer trade can help stimulate growth: it fuels competition and innovation, it helps to increase productivity, and it stimulates sustained growth with low inflation. Trade has created millions of jobs that pay above-average wages, and has helped promote the global growth upon which America's own growth and prosperity ultimately depend.

Trade now accounts for about one quarter of our economy, and export growth accounted for one-fifth of U.S. economic growth during the past decade. Together, NAFTA and the Uruguay Round Agreements boosted the annual income and lowered the cost of purchases for an average American family of four by $1,300 to $2,000. In 2001, the United States exported more that $1.0 trillion in goods and services, which generated about 10 cents of every dollar that we Americans earned.

The importance of trade to the U.S. economy underscores the need to restore momentum to trade liberalization. President Bush achieved a key objective in his trade agenda with the WTO Ministerial decision in Doha to launch multilateral trade negotiations. Negotiations are already underway for a Free Trade Area of the Americas (FTAA) and for Free Trade Agreements (FTAs) with Chile and Singapore. In January 2002, the United States announced that it will explore an FTA with the countries of Central America.

Trade liberalization offers the same benefits as a tax cut for the American consumer and the American exporter. And multilateral trade liberalization is a global tax cut for *all* consumers and exporters. A recent study estimates that cutting global trade barriers to goods and services by one-third would provide a boost of $177 billion per year to the U.S. economy – equivalent to a tax cut of $2,500 per year for the typical American family. An FTAA, the creation of which is currently being negotiated, should provide additional benefits of some $53 billion, or about $800 per year for the average American family. When combined with existing free trade agreements, an FTAA, as well as bilateral FTAs with Chile and Singapore, will fully open market access overseas for nearly 50 percent of U.S. exports.

Let me say a few words about trade in financial services, specifically. I view the liberalization of trade in financial services as another powerful instrument for accomplishing our international economic policy goals. True, we have made great strides in liberalizing trade in financial services over the past decade, but I believe we can do more – much more.

In the same way we are approaching other activities under my watch at Treasury, we are approaching trade in financial services from a goal-oriented perspective. We are asking ourselves where to concentrate our time and resources and where our efforts will truly make a difference. The growth potential in many countries is being held back by a lack of deep and liquid capital markets. For example, this potential cannot be reached when there is no secondary mortgage market, when the cost of capital is so high that it is out of reach for all but the largest companies, or when there are few if any safe markets to invest for retirement.

The swift removal of barriers in key markets will help strengthen financial systems internationally and help translate domestic savings into investment in emerging markets. Most of all, it will help enhance economic growth and stability. Freer trade in financial services will mean more American jobs in a sector with above-average wages.

I applaud the House of Representatives for approving Trade Promotion Authority (TPA). You have done a great service to our economy. It is now imperative that the Senate acts quickly and follows suit so the Congress can approve a final version of TPA and send it to the President for his signature. Without question, TPA will be a great confidence-builder for the U.S. and the global economy.

VI. Combating the Financing of Terrorism

The war against terrorism is a new kind of war being fought on many fronts. Nowhere is this truer than in the fight against terrorist financing. The President has directed me to take all measures necessary to deprive terrorists of funds. I would like to take this opportunity to share with you some of the highlights of this battlefront.

One September 23, 2001, President Bush issued an Executive order listing 27 terrorist organizations and individuals and directing the blocking of their property. This Executive order has now been extended to a total of 189 individuals and entities. To date, all but a handful of countries have committed to join this effort; 150 countries and jurisdictions now have blocking orders on terrorist assets in force; and over $104 million in terrorist assets has been frozen globally since September 11, some $34 million here in the United States, and another $70 million by other countries or jurisdictions. A portion of that amount linked to the Taliban has recently been unblocked for use by the new Afghan Interim Authority.

I emphasize our reliance on other countries because that is one of the most salient features of this front of our war. Allies have been, and remain, critical to our military efforts. On the financial front, they are absolutely indispensable. No matter how smart our bombs are, they can't destroy a bank account in a foreign jurisdiction. Blocking terrorists' access to the international financial system requires an international coalition, all working together. We will work with every nation around the globe to ensure that there is no safe haven for terrorist money.

The actions taken against the Somali-based hawaladar, Al-Barakaat, exemplify how efforts both domestically and abroad can lead to success in this war on terrorist financing. Al-Barakaat used its offices in the United States and in 40 countries to finance and support terrorists around the world. Treasury and the FBI took decisive law enforcement and blocking actions against Al-Barakaat. On November 7, 2001, federal agents executed search warrants in three cities across the country (Boston, Columbus, and Alexandria) and closed eight Al-Barakaat offices in the U.S.

In conjunction with our domestic efforts, our allies closed down Al-Barakaat offices and blocked its accounts in European countries as well. However, the key to shutting down that network and stopping the estimated $15-20 million that was flowing annually from it to Al-Qaeda was the action taken by the UAE in freezing the account of Al-Barakaat corporate headquarters. Not only was that the lion's share of the resources frozen that day, but it also meant that this conduit, which had served Al-Qaeda so well, was closed.

It is vital that we continue to build this coalition and coordinate with our international partners. We have spoken to finance officials in nearly 100 countries, and have advanced this agenda in multilateral forums. In order to measure progress, our Task Force on Terrorist Financing at Treasury is keeping track, account by account, dollar by dollar, of all countries' efforts. We have also had success pursuing international cooperation to combat terrorist financing on a global scale through a number of forums including the U.N., the G-7, the G-8, the G-20, the Financial Action Task Force (FATF), and the international financial institutions. In late October 2001, the United States hosted an Extraordinary FATF Plenary session, at which FATF members established eight Special Recommendations on Terrorist Financing. These recommendations quickly became the international standard for steps that countries can take to protect their financial systems from abuse by terrorist financiers.

Three weeks ago, the G-7 group of industrial countries met in Ottawa and agreed to an ambitious new work program. In particular, the G-7 agreed to develop a mechanism to jointly identify terrorists whose assets would be subject to freezing. This will require even closer cooperation and commitment. We will also develop key principles regarding information to be shared, the procedures for sharing it, and the protection of sensitive information.

Beginning on March 4, I will make a four-day visit to Kuwait, the United Arab Emirates (UAE), Bahrain, and Saudi Arabia. This visit will provide an opportunity to recognize the contributions made by Gulf countries to the international effort to combat terrorist financing. I hope to secure commitments from the host countries to take further concrete steps, some of them jointly with the United States, to deny terrorists the money they need to operate.

Ultimately, implementation and enforcement are the critical factors of success. The Congress and this Committee have been exceptionally helpful in giving us the statutory tools we need. In particular, Title III of the USA PATRIOT Act – the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001 – has strengthened our hand considerably against those who would harm the United States and its citizens. I thank you, and assure you that we will not let these tools get rusty.

VII. Promoting Cooperation and Coordination on International Tax Matters

International cooperation and coordination on tax matters are critically important for reducing investment distortions and for promoting the proper functioning of financial markets and systems. Tax rules should not serve as an artificial barrier to cross-border investment. That is an issue not just with respect to our own tax rules, but with respect to the interaction between our tax rules and those of our trading partners, which is why we address these issues through international agreements.

The United States has an extensive network of bilateral income tax treaties covering approximately 60 countries. The purpose of those treaties is both to coordinate our respective income tax systems so as to avoid double taxation and to reduce or eliminate tax "toll charges" on cross-border investment. We currently are working to update and modernize our existing tax treaties with our major trading partners. At the same time, we are working to expand our treaty network to cover trading partners with which we do not currently have a tax treaty relationship.

It also is critically important to establish and maintain the international relationships necessary to assist us in enforcing our tax laws. As I have said many times, we have an absolute obligation to enforce the tax laws of the United States, because failing to do so undermines the confidence of honest taxpayers in the fairness of our tax system. While we do everything we can ourselves to address the evasion of U.S. taxes, given the increasingly global nature of economic activities, we can be more effective with the cooperation of other countries.

To this end, we need to be able to obtain information from another country when we have reason to believe that a taxpayer is using the institutions of that country to evade U.S. taxes. Currently, we have effective tax information exchange arrangements with many of the world's financial centers. However, some significant financial centers have yet to enter into such an arrangement with the United States, and some of our existing arrangements do not provide for the exchange of information for all U.S. tax matters.

We will continue to work aggressively to expand and improve our tax information exchange relationships, with a particular focus on significant financial centers. I am very pleased to inform the Committee that, in furtherance of my commitment before Congress last year to produce results in this area, the United States has recently signed tax information exchange agreements with three significant jurisdictions in the Caribbean – the Cayman Islands, Antigua and Barbuda, and the Bahamas. We are in ongoing discussions with several other jurisdictions to expand further the reach of our information exchange relationships with them. We must act effectively to ensure that financial institutions are not used for cheating on U.S. taxes.

VIII. Concluding Remarks

I greatly appreciate the opportunity you have given me to present our first year achievements, ongoing efforts, and future goals on international economic issues. There is one final point I would like to make. I am determined to enable the Treasury Department to fulfill its mission to develop and implement our international economic policy. Currently, the Administration executes a large number of legislative mandates relating to U.S. participation in the international financial institutions, including requirements for directed voting, policy advocacy, certifications, notifications, and reports, that have built up over time. The U.S. Government's policy development and implementation in the IMF and the MDBs would be improved by a consolidation of these mandates. Some mandates go back 50 years. Some provisions overlap, or are inconsistent. There are 32 directed vote mandates and over 100 policy mandates, plus numerous reports, certifications, and notifications. I want the Congress to be fully informed, but numerous vestigial reporting requirements have increased the amount of time senior officials spend working on these reports to levels that warrant serious concern. I would like to work with you to rationalize and focus our mandated requirements and reports.

I look forward to continuing to work with this Committee and the rest of the Congress on our shared goal of increasing prosperity at home and abroad. Thank you, and I look forward to answering any questions that you might have.

Hearing to receive the testimony of the Secretary of the Treasury
On the International Monetary Fund
Committee on Financial Services
February 28, 2002
2128 Rayburn House Office Building

Questions for Secretary of the Treasury Paul H. O'Neill submitted by Dave Weldon, Member of Congress

Mr. Secretary, you state in your testimony the accomplishments your agency has made in combating the financing of terrorism and I wish to commend you for this exemplary work. You also cite the work of this Committee in providing tools to fight the financing of terrorism in the USA Patriot Act.

Are there any specific tools the Patriot Act failed to afford you as you combat the financing of terrorism (or to encourage the cooperation of other countries in our fight)? If so, please cite these oversights in detail.

Mr. Secretary, you also mentioned your work with the G-7 to combat the financing of terrorism and that you are developing agreements on principles and procedures with them regarding information exchange (the sharing of financial information) and the protection of sensitive information. What commitments by the United States have been extended or agreed to in return for these agreements?

Please describe for me how the Patriot Act will help you accomplish this goal of securing financial exchange agreements with G7 Nations and others?

Do you need to rely on other tools outside of the Patriot Act to accomplish this?

What steps are you taking to make sure that no harmful side effects or unintended consequences to our economy will be realized by these agreements?

What steps are you taking to make sure that these measures are narrowly crafted to identifying terrorist financial activity and that the right to privacy for legitimate depositors is not infringed?

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